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Political uncertainty heightened after Biden's withdrawal, Trumps Trade Comes in play

June FOMC may lay ground for future rate cut

The week started with assassination attempt on Donald trump which ended with him accepting the republican nomination for US Presidential election and puzzle over global cyber outage. Meanwhile Biden has ended his re-election campaign and endorsed Kamala Harris to succeed him as the Democratic candidate. On data front the week was light with the release of US retail sales along with ECB monetary policy. The FED officials continued to exhibit, hesitancy to hastily make interest rate cuts, sticking to a data-dependent approach. While ECB monetary policy was on expected lines as Lagarde maintained status quo and kept door open for September rate cut.

The key FX theme for last week are outlined below. In the coming week US GDP data, PCE Price Index and any further development with respect to US presidential elections will be of key importance.

- ♣ FED monetary policy and US Presidential election conflicting drivers for US Dollar
- ♣ US Yield Curve Steepening showing confidence on FED rate cut
- ♣ ECB maintained status quo, door open for September rate cut
- ♣ US-China trade war to mount pressure on CNY, Third Plenum says nothing unexpected
- ♣ Rupee drifts lower despite weak US dollar; Union budget will be in focus

#### FED monetary policy and US Presidential election conflicting drivers for US Dollar

The US Dollar ended the week on a stronger note closing at 104.36 levels (up c.0.27% w/w), while the US 10-year yield ended flat at 4.24% levels. The US dollar strengthened mostly on last day of week as investors prepared themselves for Fed's favourite inflation indicator, the PCE Price index. Also, the global tech outage worst ever in history affected the industries worldwide and enhanced the US dollar safe even appeal. Retail sales, industrial production, housing starts and building permits for June exceeded consensus forecasts, showing resilience.

The political uncertainty in US has risen, after Joe Biden decided to end his re-election campaign and endorsed Kamala Harris to succeed him as the Democratic candidate. This has led to Trump trade (i.e. sell US dollar which is down c.0.15% since announcement, bitcoin is up, while gold is up over uncertainty). During the week, Donald Trump appointed JD Vance as his deputy, Vance is a populist who will forcefully advocate for Trump's protectionist trade policies while he has called China the biggest threat to the US. Trump during an interview said he didn't like the dollar's strength especially against the Japanese yen and Chinese yuan. This strategy weakens the dollar which aims to boost exports by making them cheaper on the global market. However, this could undermine the dollar's status as worlds dominant currency. He outlined the fiscal policy by reducing the tax limits and increase spending on infrastructure while acknowledged that a 1% cut to corporate tax was more likely. Trump has called for 60% tariff hike on imports from China. When asked about Powell's tenure, Trump said he was doing the right thing and may complete his tenure.

#### July FOMC may lay foundation for September rate cuts.

Fed Chair Jerome Powell this week stated that the inflation figures "add somewhat to confidence" that the pace of price increases is returning to the central bank's target sustainably, after describing the US economy as "no longer overheated". While other FED members statement was along the same lines we feel that 31st July meeting will set the tone for its September rate cut. The CME Fedwatch tool shows 98% probability of rate cut in Sep'24. This week the US PCE data will be in focus as any decline in print may support FED rate cut hopes and weaken the US dollar. The PCE Price index MoM is expected to rise 0.1% as against 0%, core PCE is expected to remain same. We feel in short term there might be some selling in US dollar on rate cut expectations but the losses might be capped due to uncertainty in election and inflationary policies of Trump which may see safe heaven flows in US dollar. Technical levels show, DXY may get support from 103.50 levels while the upside seems capped at 104.80 in the coming week.

Speculators increased bearish bets on US 10Y treasury Futures.

ECB repeated the rhetoric of data dependency and didn't provide any further guidance on rate cut.

### **IMF signals of bumpy road to the path of recovery:**

In its latest World Economic Outlook update, The IMF stated that upside risks to inflation have increased, calling into question the prospect of multiple Federal Reserve interest rate cuts this year. The IMF said “the momentum on global disinflation is slowing, signalling bumps along the path.” The rise in sequential inflation in the U.S. earlier in 2024 has put it behind other major economies in the quantitative easing path. Across advanced economies globally, the IMF forecasts the rate of disinflation to slow in 2024 and 2025 due to broadly high service inflation and commodity prices. That is because inflation in prices for services is now expected to be more persistent and commodity prices higher. Concerning the U.S. economy, the financial institution lowered its growth outlook by 0.1% to 2.6% in 2024 on cooling consumption and slower-than-expected growth at the start of the year.

### **US Yield Curve Steepening showing confidence on FED rate cut.**

The shape of the yield curve is often considered to be a leading indicator of economic activity. When a recession is not expected, near-term yields tend to be lower than rates further out the curve, since investors demand a term premium to compensate them for future uncertainty over yields.

Since July 2022, the yield curve has been inverted i.e. the near-term yields are higher than those of longer tenure, indicating concerns over the economy. (Fig 2 shows the curve has been inverted since the 2022). The steepness of the yield curve is a reflection of market expectations regarding economic growth, interest rate movements and inflation. As recently after the betting odds showed c.61% probability of Trumps win's in November election, the longer-term bond yields have risen as his policy are generally termed to be inflationary, focused on reducing the taxes which may be a drag on fiscal front along with lower policy rates. The recently released US CPI data which showed inflation softening while higher unemployment rate have raised the probability of September rate cut by FED which have soften the yields on shorter duration. In the near term the bond volatility may rise especially during the November.

The recent released data by CFTC on 19th July shows speculators increased bearish bets on U.S. T-10Y futures, with net shorts hitting their largest in more than four months. On the other hand, the speculators have reduced their net short positions on two-year futures. This increase in net shorts on the 10-Y and a decline on bearish bets on the front end reflect a steepening yield curve.

### **ECB maintained status quo, door open for September rate cut**

The European Central Bank unanimously held all its three key rates unchanged in their 18th July meeting, on expected lines. While stating that the incoming information broadly supports ECB's previous assessment of the medium-term inflation outlook. This decision was followed by last month's landmark rate cut after maintaining a restrictive interest rate framework for two years to tame inflationary pressure.

#### **➤ ECB stays non-committal on next rate cut**

- Lagarde when asked about September rate cut in press conference said the rate path is not predetermined and that September move is wide open.
- The Council emphasized a data-driven strategy, continuously monitoring economic indicators, inflation trends, and the effectiveness of its monetary measures to make informed decisions about rate adjustments.
- During the press conference, there was very little that she offered while the ECB really seems to be sticking to the plan not to give any forward guidance.
- ECB in its monetary policy decision specifically stated that domestic price pressures remain at an elevated level, and that services inflation is expected to hold above the target well into next year.
- While the risks to economic growth are tilted to the downside, a weaker world economy or an escalation in trade tensions between major economies would weigh on euro area growth.
- While Lagarde was non-committal the market is pricing in 80% probability for September rate cut and total two rate cut for this year.

Rupee trading at all time low despite strong inflows

CNY feeling the heat of possible Trumps trade war, cuts interest rate In a surprise move

## Rupee drifts lower despite weak US dollar; Union budget will be in focus

The 2nd week of July saw major global currencies trading higher amid lower than expected US CPI data, which equally dropped the US yields and a surge in rate cut expectations. Markets are fully pricing September rate cut and total 3 rate cuts this year. However, the losses were recovered by odds of interest rate cuts increased by the weak jobs data which dented the greenback.

Strong FPI flows is seen in debt & equity for the month of July at \$ 482b, even then Rupee traded in a narrow range throughout the week but closed at all-time lows. Rupee is one of the weak performing currency among the Asian peers. Month end importer buying by large state bank capped rupee to gain despite weak Dollar. Also, the weakening Chinese Yuan on the back of US-China trade war is something traders are looking at. Last week, RBI absorbed some of the flows using its record high forex reserves \$666.85 billion kitty which may have limited the rise in rupee.

The Union Budget scheduled on 23rd July will be highly watched and give further guidance to the currency pair. The fiscal deficit is forecasted to be 5.1% of GDP in 2024-25, with an aim to reduce it below 4.5% by FY26, that is also anticipated to improve India's sovereign credit rating and economic standing, which will in turn support Rupee. INR traded range bound throughout the week from 83.5350 to 83.6675. For the coming week, we expect the domestic currency to trade range bound, technically taking a support of 83.23 and will find a strong resistance above 83.73 levels. (Refer our prev. Report [UniFX-june24](#)).

## US-China trade war to mount pressure on CNY, Third Plenum says nothing unexpected:

China's Yuan heads back to its 7-month low (Nov'23, Yuan @ 7.2980) against the dollar this week. In a surprise move the PBoC cuts the seven-day reverse repo rate by 10 basis points, followed by a lowering of the one-year and five-year loan prime rates. This has led to marginally weakening of the yen.

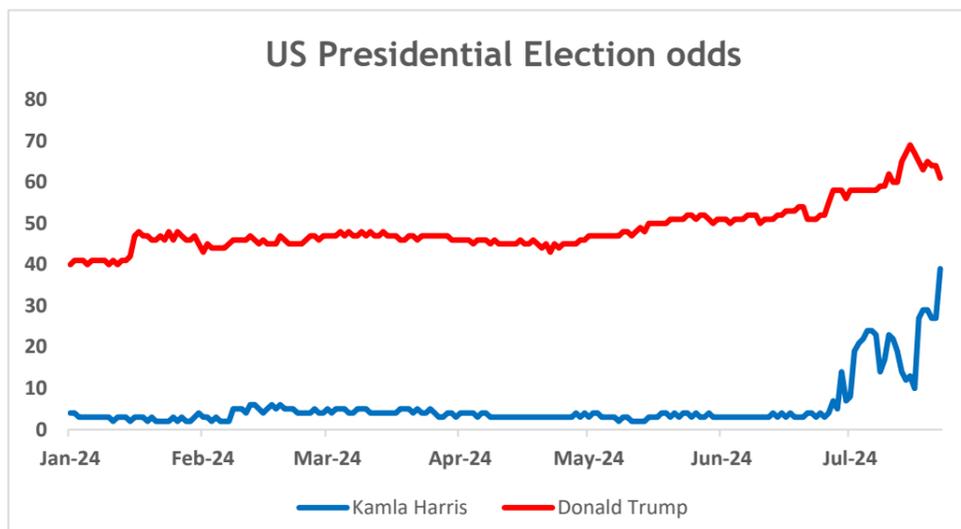
For the past few months, PBoC had been holding its rates back, likely in part to keep CNY steady amid USD strength. This move could weaken the yen in short term if PBoC easing continues, once U.S. easing starts yield spreads could move in favour of CNY as the scale of U.S. cuts is likely to be larger than China's.

The Third Plenum readout affirmed Beijing's commitment to balancing development with ensuring national security, and did not otherwise reveal policy changes. The communique reaffirms China's focus on high quality development and deepening reforms across the economy, without announcing further stimulus for near term growth. The communique shows China's leadership is staying the course in the sense it wants to avoid the worst but it's not yet convinced the policies the U.S. has used is the best for China. Concerns are growing that without a structural shift that gives consumers a greater role in the economy, debt will continue to outpace growth in order to finance Beijing's industrial modernization and global prominence goals. Technically for the coming week, support is seen at 7.2469 levels and resistance at 7.2811 levels.

Market Weekly Performance			
Currency	Close	W-o-w Change	Week Trend
DXY	104.36	0.27%	↑
USD/INR	83.663	0.15%	↑
EUR/USD	1.0881	-0.21%	↓
GBP/USD	1.291	-0.58%	↓
AUD/USD	0.6684	-1.45%	↓
USD/JPY	157.38	-0.33%	↓

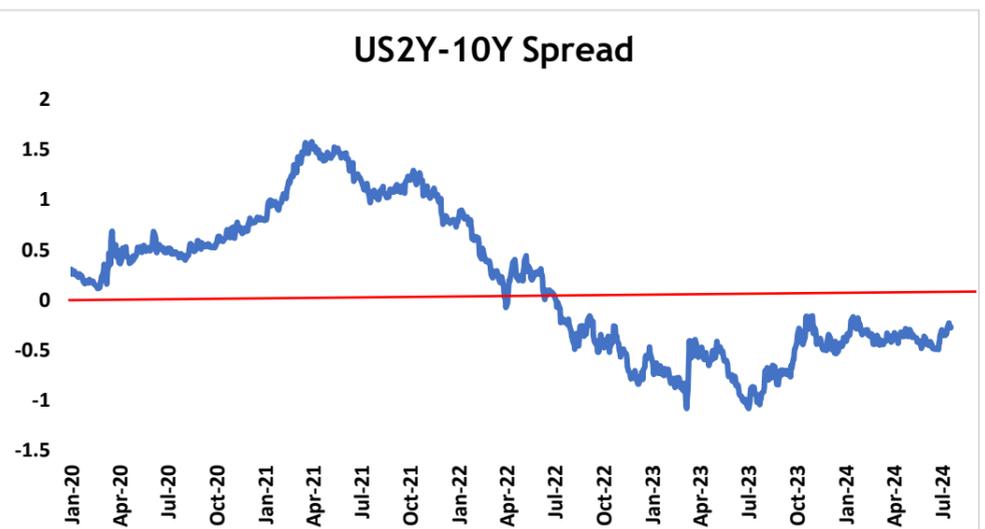
Next Week Economic Indicators						
Date	Time (IST)	Country	Data	Month	Forecast	Previous
23.July.24	19:30	US	Existing Home Sales	June	3.99m	4.11m
23.July.24	11:00	IN	Union Budget 2024	-	-	-
24.July.24	13:00	EU	Germany Flash Mfg PMI	July	44.1	43.5
24.July.24	13:00	EU	Germany Flash Service PMI	July	53.3	53.1
24.July.24	13:30	EU	Eurozone Flash Mfg PMI	July	46	45.8
24.July.24	13:30	EU	Eurozone Flash Service PMI	July	52.9	52.8
24.July.24	14:00	UK	S&P Composite PMI Flash	July	52.5	52.3
24.July.24	19:15	US	S&P Manufacturing PMI Flash	July	51.5	51.6
25.July.24	18:00	US	Advanced GDP q/q	Q2	1.9	1.4
25.July.24	18:00	US	Jobless Claims	July	239k	243k
25.July.24	20:30	EU	ECB Lagarde Speaks	-	-	-
26.July.24	18:00	US	Core PCE Price Index m/m	June	0.1%	0%
26.July.24	19:30	US	Michigan Consumer Sentiment	July	66	68.2

After Biden withdraw his nomination from Presidential election probability of Trump has slightly declined from 64% to 61% (Fig 1)

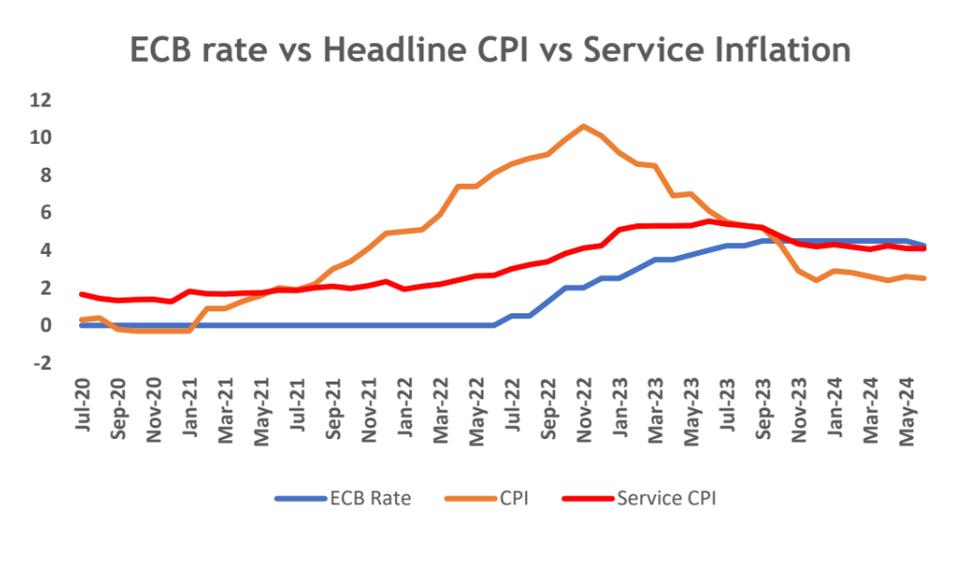


Source: Bloomberg, UBI Research, CME Fedwatch Tool

Yield curve has been inverted since 2022 and have started steepening (Fig 2)

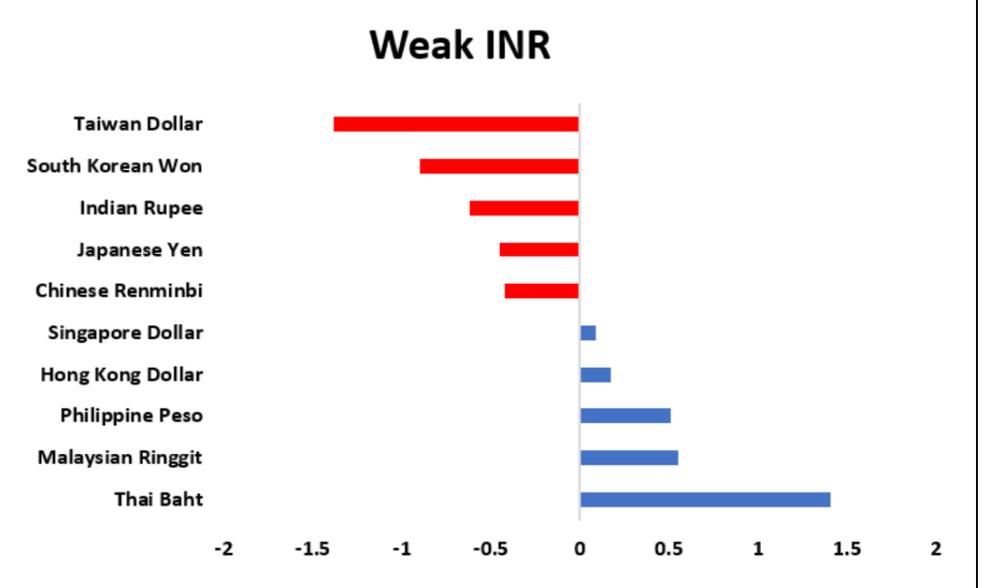


Although deflation pressure persists, service sector inflation remains high (%YoY) (Fig 3)

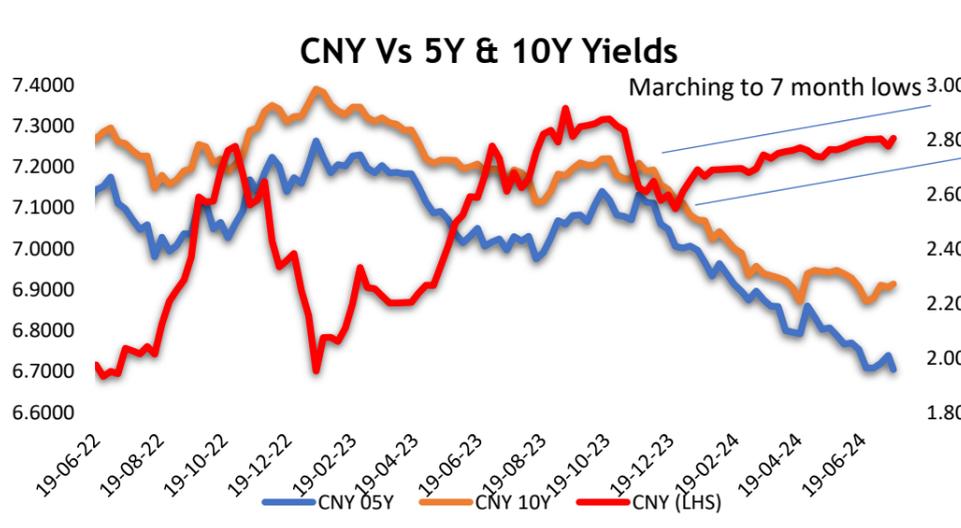


Source: Bloomberg, Reuters, real clear politics

Rupee was one of the weakest performing currency in Asia since March 6<sup>th</sup> (Fig 4)

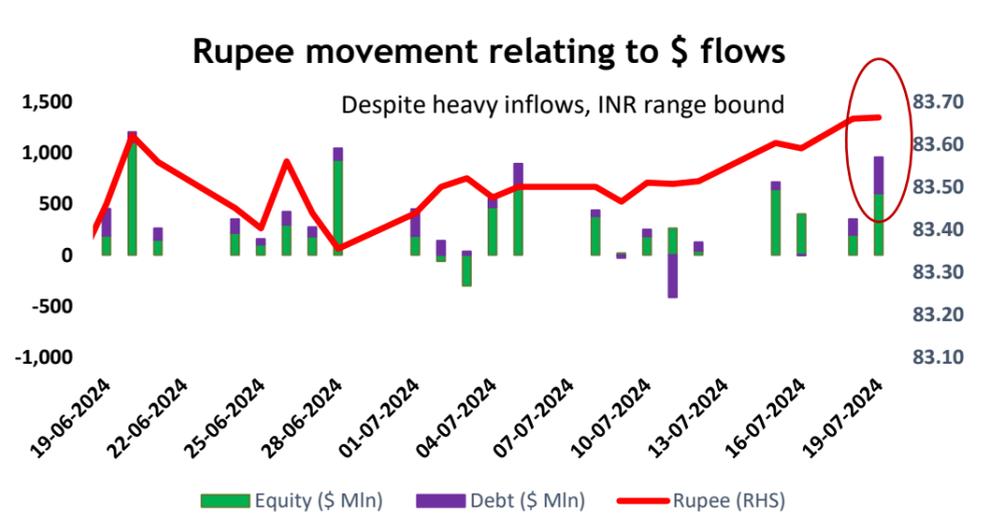


CNY feeling the heat of possible Trumps trade war



Source: Bloomberg & UBI Research

Rupee traded weak despite strong inflows



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