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Fears tied to weakening growth in US, the repricing of recession probabilities & divergent central bank policies (i.e. Fed / BOJ) amplified market volatility.

Statements from central bankers over the week calmed the markets nerve as market overreacted on US job data.

Last week we saw sanity return to global markets after seeing sea of red across risky asset on black Monday. While markets got worried about deep recession fears in the US, central banks (especially BoJ & FED) via verbal intervention tried to get some sanity back in markets. Also, better than expected US growth indicators like services PMI, retail sales and jobless claims helped. In our view, markets overreacted and made the same mistake as it did at the starting of year by predicting 5 FED rates cut in 2024.

This week, we saw sharp swing in US Dollar and rates on release of a host of data prints-(subdued) US PPI, CPI along with (better than expected) retail sales and jobless claims numbers. US equities have shown some buying interest on somewhat eased fears about a more pronounced slowdown in the world's largest economy. (Pls refer: [Uni-Fx: Markets in Mayhem mode amid US recession fears & unwinding of carry trades](#))

The key FX themes for last week are outlined below. Coming week Jackson Hole Symposium will be important where FED chair Powell will speak on 23rd August which comes ahead of crucial September policy meet. Also, any further news from China which recently saw record outflow of foreign funds c.\$15B in Q2 and hence is on course for first annual net outflow since 1990.

- ♣ US recession concerns overexaggerated; calm central banks helps soothe market nerves
- ♣ FED might cut rate gradually while market pricing looks aggressive
- ♣ US CPI Continues its downward trajectory & supports disinflation scenario
- ♣ Rupee at record lows despite weak Dollar, RBI MPC outcome hawkish but market sentiments were tranquil

Swing in market- From meltdown to relative stability

Recession concerns in US amplified post US NFP data yet Fed did not react to one data point and other growth indicators like services PMI, retail sales, jobless claims etc helped soothe market nerves.

What added to volatility was unwinding of Yen carry trades. There is lack of consensus on extent of unwinding done till now. Geopolitical tensions still persist in the middle east between Iran and Israel which led oil surpassing the 80\$/bbl. mark.

Central bankers calm the market nerves

Sharp swings in both US Dollar and rates witnessed during the last two weeks. The Dollar Index fell to seven-month lows at (-102.15) starting of the month before gradually but consistently rose to reach about 103.40 levels. Meanwhile after the release of CPI data the DXY again slipped below the psychological 102.50 threshold level. The turnaround in the DXY was caused by the release of US CPI and weekly jobs data which fell by 7k to 227k in the week ending August 10 and was lower than the expectation of 234k. The comments from various FED members over the week also calmed the market nerves as it was not evident that the FED was in hurry to cut rates. (i.e. statement from FED Governor Michelle Bowman, Barkin & Schmid). The CME FedWatch which at the stating of week showed 97% probability of 50bps rate cut in September meeting has significantly been reduced to 25%.

The statements from BoJ's Uchida where he asserted that BoJ won't hike rates when markets are unstable and believes US economy can achieve soft landing supported the Japanese stocks and weakened the Yen. The USDJPY appreciation to 141.20 levels as markets were worried that US and Japan interest rate differential might reduce by faster pace.

FED might cut rate gradually by 25 bps in September while market pricing looks aggressive

The July PPI report and NFIB survey were, overall, positive signals. NFIB business optimism index registered at 93.7 above expectations of 91.7, highest reading since February 2022. US producer price index rose less than expected, with headline up just 0.1% vs expectation of flat 0.2% and core PPI showed rise of 0.3% in July on MoM basis.

Economic growth indicators to keep supporting US economy. FED might start cutting rates by 25 bps in September meeting.

Headline CPI falls below 3%, its first since March 2021 due to fall in energy prices

Retail sales on MoM basis increased by 1% in July vis-à-vis -0.2% in June, surpassing an estimate of 0.3% uptick. While core retail sales on MoM basis clocked 0.4% in July vis-à-vis 0.5% in June below the estimate of 0.5%. The GDP data are also not showing any signs of weakness. FED Atlanta estimates US economy will continue to do better in Q3'24, to grow by 2.9% vis-a-vis 2.8% in Q2. The interest rate for the most popular U.S. home loan plunged to its lowest level in 15 months. The average contract rate on a 30-year fixed-rate mortgage dropped 27 basis points week ended Aug. 2, to 6.55%. That was the lowest rate since May 2023 and the sharpest drop in two years.

While markets worried about recession strong ISM services index denied this threat

The July US ISM service index rose to 51.4 from 48.8, above the 51.0 consensus estimate. New orders jumped to 52.4 from 47.3 while employment was back in growth territory at 51.1 from 46.1. The production index is particularly strong at 54.5 versus 49.6. As such this doesn't fit the impending recession narrative that has gripped markets over the past couple of weeks.

As this indicator of growth along with others highlighted above are not showing any sign of weakness, while the recently released NFP data was weak mainly due to cuts in temporary job profiles, we may not see a repeat of such prints in August data. **We feel the FED might adopt a gradualist approach with a start of 25bps rate cut in September and subsequently in each meeting next year. FED might be reluctant to be proactive and will follow data dependent approach. If it overreacts it might exaggerate the unwinding of carry trade and sharply weaken investor sentiment which might induce recession fears.**

US Treasury yields partly reversed as recession fears have subsided.

The yield on the 10-year US Treasury has been moving back and forth when it fell below 4% at the start of August for the first time since February. Economic pessimism contributed to a slide to an intraday low of 3.66% on 5th August. However, over the course of the week, the yield again rose 3.93% due to encouraging consumer and labour data.

US CPI: Continues its downward trajectory & supports disinflation scenario

Inflationary pressure continues to ease in US as July CPI data came in line with market expectations. The consumer price index rose by 0.2% in July on a seasonally adjusted basis, after declining 0.1% in June. On YoY basis the CPI increased by 2.9% in July after advancing 3% in June as against EST. of 3%. While the CPI still may be above the FED's ideal 2% target, but it is the first reading which came below 3% since March 2021. This reading largely sums it up that the FED might have enough data to make the call to cut interest rates in its September FOMC meeting. While the market is still divided if the cut would be of 25/50bps, **we expect the FED might cut rate gradually by 25bps in September FOMC meet and subsequently in each meeting next year.**

Headline CPI for June shows decline on YoY basis due to fall in energy prices:

- The monthly headline CPI stayed flat at 0.2% in July on a seasonally adjusted basis in line with market EST of 0.2%, while most importantly on YoY basis it declined to 2.9% in July vis-à-vis 3% in June below the market EST of 3%. This decline below 3% is first since March 2021.
- Food index increased by 0.2% in July, as it did in June and has eased substantially from its peak. Index for food at home rose by 0.1%, while food away from home index rose by 0.2% in July after rising 0.4% in each of preceding two months. Although the stated factors were soft on monthly basis, other categories saw substantial increase, amongst them was eggs up 5.5%.
- The prices of energy, specifically retail gas, has been another source of deflation. **The US retail gas prices currently at 3.53 levels down from 3.94 a year ago (C.10.41% fall).** The energy index was unchanged in July, after decreasing 2% in June. Gasoline index in July also remained unchanged after declining the previous month by 3.8%. The electricity index increased by 0.1% and fuel oil index by 0.9% on M/M basis, while the index for natural gas fell by 0.7% in July.

Supercore inflation indicate ongoing price pressure

Trump wants say in central banks policies while Kamala Harris shares contrast views.

Core CPI (ex food & energy) stays at same level mainly due to increase in shelter index

- The core CPI on M/M basis stayed flat at 0.2% in July after rising 0.1% in preceding month and in line with market EST of 0.2%. While on YoY basis it stayed flat at 3.2% in July while was again in line with market estimate.
- The housing costs continues to drive inflation higher, main contributor towards the headline inflation was index for shelter which has risen by 0.4% in July vis-à-vis 0.2% fall in June, which accounted for 90% of the monthly increase in all the item index.
- Along with shelter index motor vehicle insurance index which rose by 1.2% in July, following a 0.9% increase in June. The index for household furnishings and operations increased 0.3% over the month. The indexes for education, recreation, and personal care also increased in July, while index for rent rose 0.5% over the month. These indices are not in control of FED and might stay elevated even in consequent months.
- The resurgence of supercore inflation indicate ongoing price pressure. In July, supercore rebounded by 0.21% after two consecutive monthly decline, though on annual basis it declined slightly to 4.48% from 4.67% in June.
- The index which cooled off were medical care index fell 0.2% in July, after rising 0.2% in June. The index for hospital services fell 1.1% in July. The index for used cars and trucks fell 2.3 % in July, following a 1.5% decrease in June.

FED's independence may be threatened under Trump administration while Kamala Harris is leading Trump in key US states.

Republican presidential candidate Donald Trump last week offered the most explicit indication so far of his interest in infringing on the Federal Reserve's independence should he regain the White House. Trump stated that he feels that US President should have at least say in there" on Fed decisions. His comment follows report that Trump allies have drafted proposals that would attempt to erode the Fed's independence if he wins the US Presidential election.

Vice President Kamala Harris shares contrast view and believes the Fed should make decisions independent of the US President. While in recent Presidential polls Kamala Harris is ahead of Donald Trump in the key states of Michigan, Wisconsin & Pennsylvania, according to New York Times poll. The second Presidential debate is expected on September 10th for the first time between Trump and kamala Harris.

Trump stated that he expects the US Dollar to weaken specially against the Chinese Yuan and Japanese Yen. Weaker dollar would make imports much more expensive for Americans and make U.S. exports that much more attractive on global markets. While if elected as President he might impose 60% tariff on Chinese imports and reduce taxes. While his policies are inflationary to the economy, it might be difficult for him to implement such high tariffs, which he stated during the election campaign the US Dollar might strengthen conversely to his views.

Rupee at record lows despite weak Dollar, RBI MPC outcome hawkish but market sentiments were tranquil

August started with a market mayhem after US NFP data developed hysteria among the global investors. Major global currencies witnessed rallies but thereafter corrected after US ISM service data helped bypass recession fear. The CME Fed-watch tool now shows 50 bps rate cut probability down to 25% in Sep'24 down from 74% a week ago. Markets are still pricing in 4 rate cuts in total, commencing Sep'24 against the FED conservative expectations of 1-2 cuts.

However, Rupee traded against the tide & hit fresh all-time lows (On 06th Aug'24 @ 83.9850); where the downside (Psychological barrier of 84.00) was mainly capped. Continuous Dollar sales by major PSBs was seen to avoid knee jerk depreciation in the domestic currency although a gradual weakening was noted. The local currency kept depreciating amid Dollar bids from importers, oil & gold buying demand. Also, Dollar short squeeze was seen in the domestic market as the inflows induced by JP Morgan index inclusion did not hit the market and hence dollar supply has taken a hit now.

RBI MPC outcome did not support rupee.

Equity outflows continued while debt inflows remain capped

Rupee being a depreciating currency (2-3% annually) had been the best performing currency among the Asian peers since March 2022 (Fig 9). When the DXY surged due to safe haven demand (Russia-Ukraine war) and was hovering at high levels (DXY @ 107), INR did not depreciate accordingly. Similarly, rupee refrained from appreciation when the DXY is cooling down amid FED rate cut scenario. As per given conditions, INR to depreciate gradually now (1-2% annually) and trade in a narrow corridor (Fig 10).

Along with regular VRRR, RBI continued OMO sales for 5th consecutive week with a total sale of Rs 2510 crs in the week ended 09th August & cumulative of Rs. 14,205 crs to absorb surplus liquidity amid FAR related inflows. The record high forex reserves kitty shrank by \$4.80bln to \$670.1bln (\$3.30bln rise was adjusted after valuation effects).

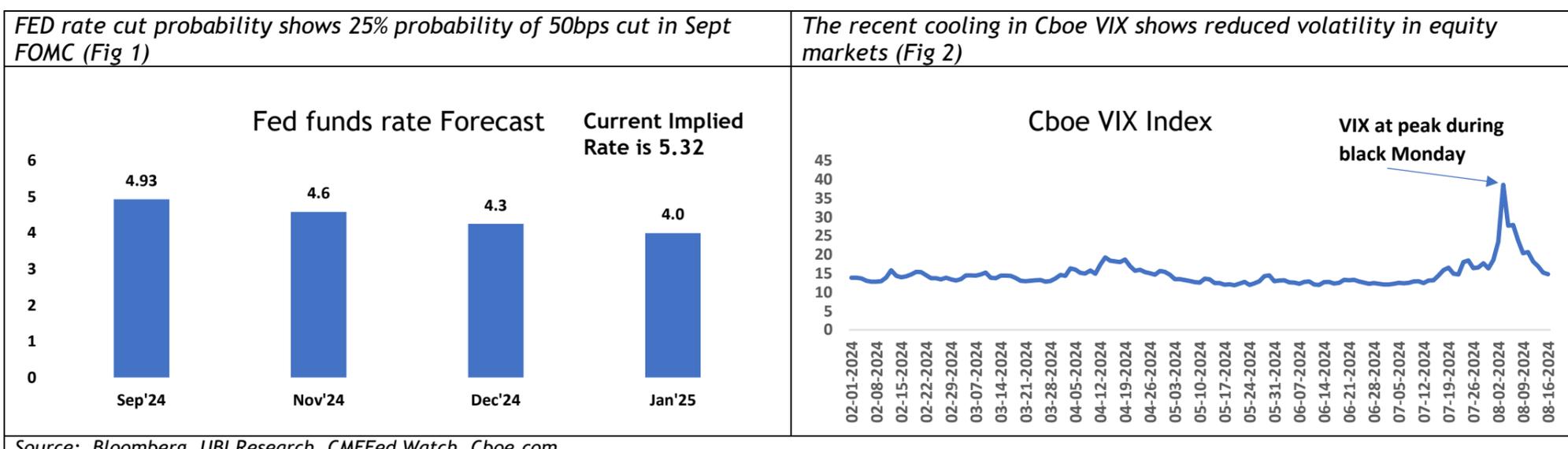
RBI MPC outcome came in line with our expectations & voted for status quo on repo rate at 6.5% and withdrawal of accommodation policy stance (Pls refer: [“RBI August MPC decision: Will this be a non-event?”](#)). Absence of drastic measures on liquidity management (i.e. OMO Sales calendar) did not disrupt any market sentiments.

MPC sounded hawkish with concerns regarding food inflation pressures. In our view, the Governor made a clear assertion that the RBI stays focused on elevated food inflation (above 8% consistently since Nov’23) as it endangers a spill over impact on record low core CPI of c.3%. In fact, in Jan’24, RBI DG Patra released a paper titled, [“Are Food Prices the ‘True’ Core of India’s Inflation?”](#). Overall, while the MPC kept FY25 inflation projection unchanged at 4.5% even as Q2 forecast was revised up by 60bps to 4.4% from 3.8% earlier.

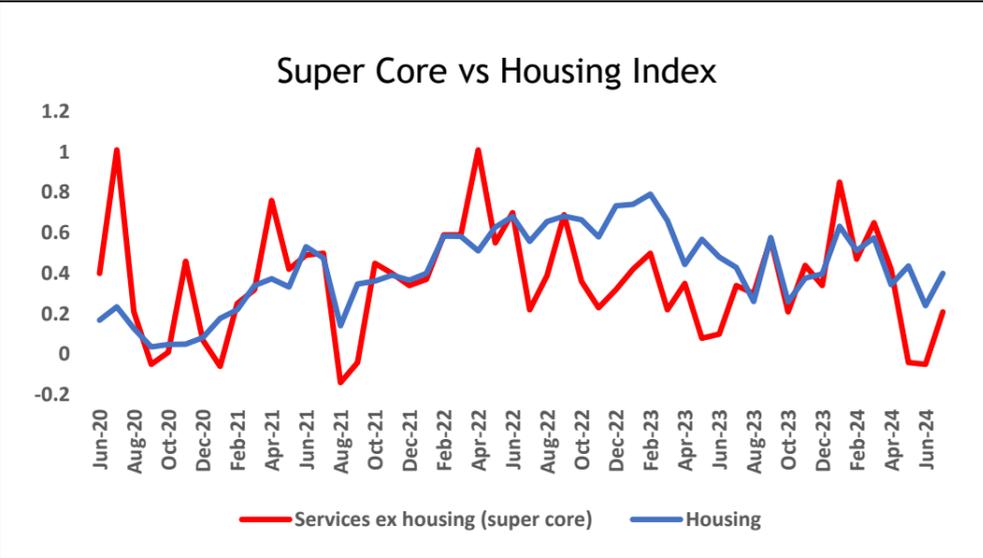
In our view, the most important statement in the RBI MPC from the Governor was that, “During 2024-25 (up to August 7), [the Indian rupee \(INR\) remained largely range-bound](#). The lower volatility of the INR bears testimony to India’s macroeconomic and financial stability, and an improving external sector outlook”. While FED is expected to start rate cut in September we feel the RBI is expected to stay on pause. However, the rise in interest rate differential is likely to open doors for more FPI flows in the coming months. Meanwhile, in short term the current risk aversion scenario will strengthen US dollar on safe haven buying spree and drive depreciation pressure on rupee.

In this week, FPI outflows though moderated but continued in the equity segment, \$(925.53) mln vis-a-vis from \$(1,479.35) mln a week ago, while the debt has seen a marginal increase of inflows to \$339.61mln vis-à-vis \$312.68mln a week ago.

Throughout the week, INR traded in a very narrow range with a depreciating bias from 83.7900 to 83.9850 and made the worst performing currency among the Asian peers. For the coming week, we expect the domestic currency to remain under pressure, in the wake of increased Dollar demand, technically should take support of 83.56 and will find a strong resistance around 83.98 levels, failure of which will test 84.16 levels (NDF highs).

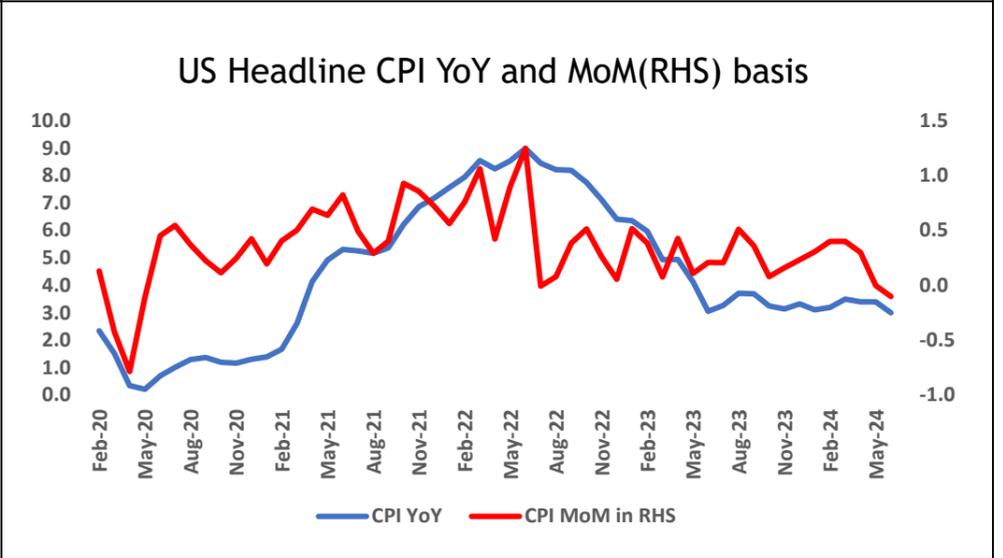


Supercore indicate ongoing price pressures (Fig 3)

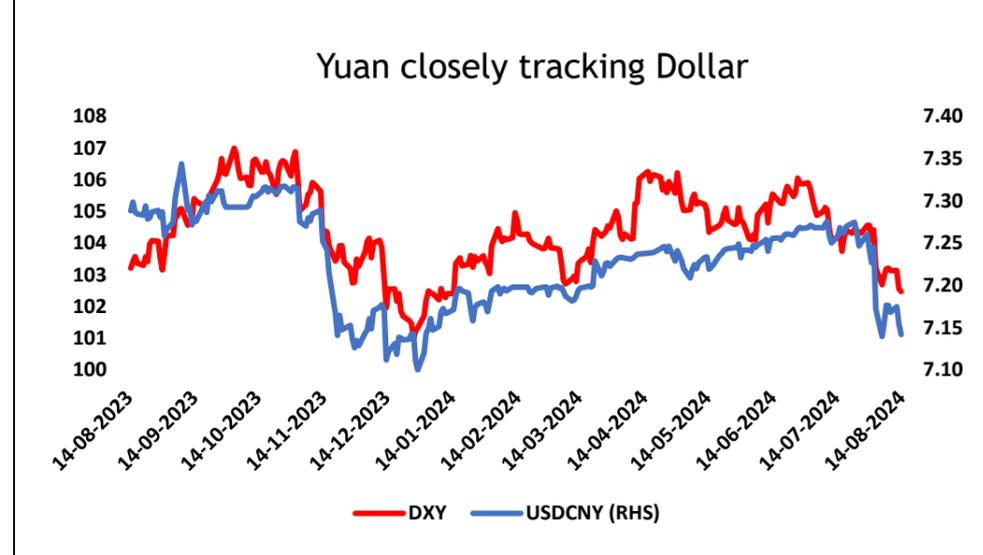


Source: Bloomberg, Reuters, bls.gov

Headline inflation eases first after March 2021 (Fig 4)

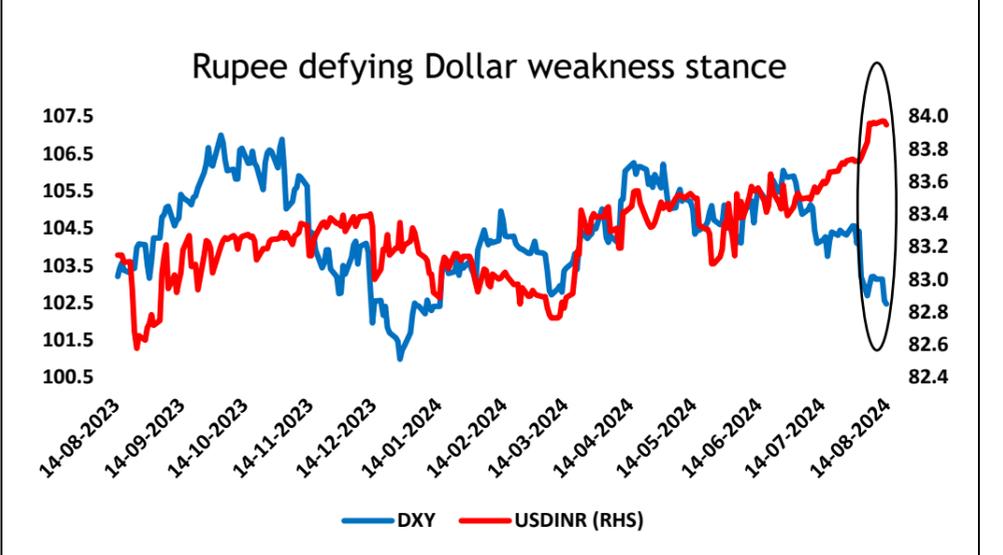


Chinese Yuan tracking the US Dollar moves (Fig 5)

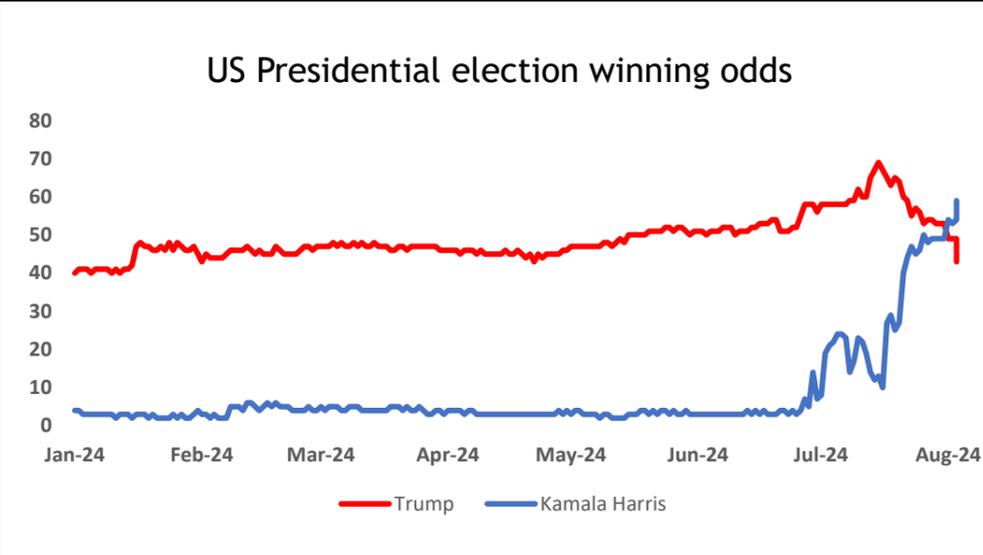


Source: Bloomberg, Reuters

Rupee weakening despite US Dollar weakness (Fig 6)

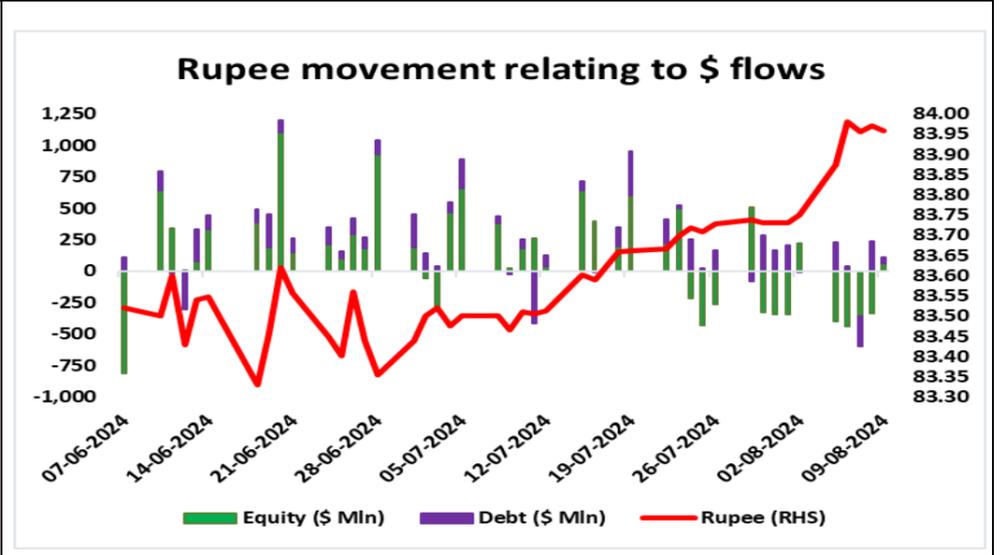


The recent Poll shows Kamala Harris winning odd stands at 59% (Fig 7)

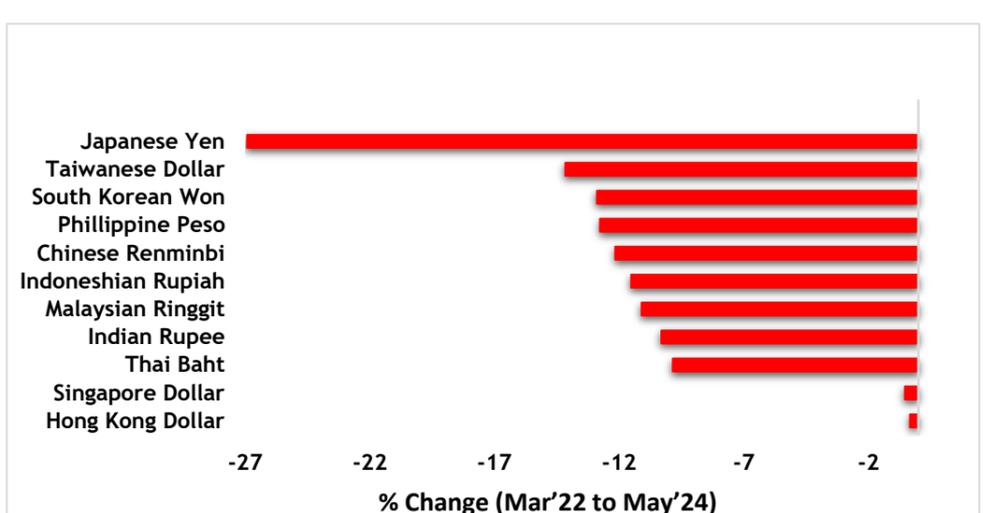


Source: Bloomberg, Reuters, PredictIT, UBI Research

Continuous outflow putting pressure on INR (Fig 8)

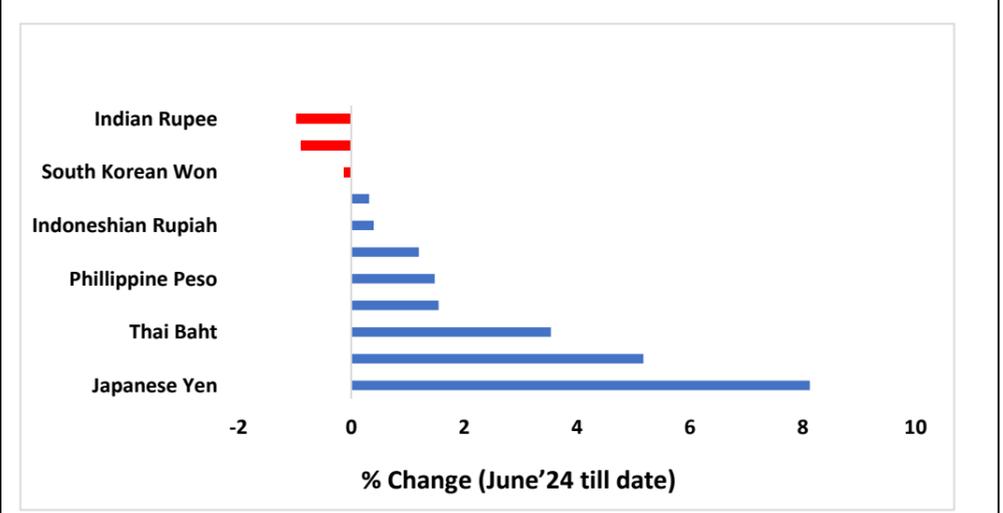


INR performing best among Asian peers (Fig 9)



Source: Bloomberg, UBI Research

INR performing worst among Asian peers (Fig 10)



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