26thAug 2024 - 02nd Sept 2024

By:

Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Akash Deb
akash510@unionbankofindia.bank

Shreyas Bidarkar
shreyas.bidarkar@unionbankofindia.bank

Last week we saw some positive data from US which reaffirmed soft-landing scenario. Consumer sentiment has risen, household spending picks up while the FED's favourite inflation indicator PCE stays on declining trend and has set the stage for (25bps) September rate cut. The one key data point before the September FOMC meeting is August US jobs report to be released this week. In Eurozone headline inflation slowed, while service prices still remain a major concern.

In Asia where we saw slight upside in Australia's inflation in July which might prompt RBA policymaker to keep their cash rate on hold for this year. India released its GDP data for Q1FY25 which hit 15-month low of 6.7% compared to 8.2% a year ago. While China continues to struggle with its growth as its factory activity shrank the most in four months.

The key FX themes from last week are outlined below. Coming week the key focus remains on, labor data from US (JOLTS, NFP, Unemployment rate) which might give us idea on size of September rate cut along with China's PMI data and rate decision from Bank of Canada. (**Pls refer**: Uni-Fx: Markets in Mayhem mode amid US recession fears & unwinding of carry trades)

- ♣ **Positive economic data from US, while divide on quantum of rate cut continues**
- ♣ **September rate cut is done deal but the jobs report will determine the magnitude of cut**
- ♣ **More bad news from German economy continues**
- ♣ **Rupee advances on robust FPI inflows amid MSCI rejig**

Positive economic data from US, while divide on quantum of rate cut continues

Positive economic data subsides recession fears while search for quantum of rate cut continues

Positive economic data from US started to flow last week while market participants and policy watchers are still on a lookout for clues as to size of rate cut. The consumer confidence index for August rose to 103.3 highest level for six months while July's data was also revised upward to 101.9. The current CME FedWatch tool shows 70% probability of 25bps rate cut in September, 100bps by year end. Last week economic indicator broadly beat market expectations and reaffirmed economic soft landing. Those indicators are stated below.

Consumer spending lifts Q2 GDP growth to 3%

The US economy grew by 3% on an annual basis in Q2, an upward revision to the second estimate that exceeded expectations. The upward revision can be attributed to robust pace of consumer spending which has grown by 2.9% annually, up from previously 2.3%. Compared to the first quarter, the acceleration in real GDP in the second quarter primarily reflected an upturn in private inventory investment and an acceleration in consumer spending. These movements were partly offset by a downturn in residential fixed investment.

Declining PCE data keeps the FED on rate cut path

PCE data indicated strong spending

The core PCE deflator, came in at 0.2% on MoM basis on expected lines while on YoY basis it stayed at 2.6% below the market expectation of 2.7%. While to three decimal places it was 0.161% on MoM basis a number good than 0.2%.

Additionally, the PCE report indicated spending remained strong, but real disposable income growth remained weak. The real consumer spending rose 0.4% MoM vis-à-vis 0.3% expected while there were upward revisions to April, May and June data. The real disposable incomes rose just by 0.1% MoM same as in June. While the saving rate has dropped to 2.9%.

US Dollar saw mild recovery from recent lows, while yields continue to show volatility

The US dollar has fallen c.3% in August moving to the lowest level since Dec23. The factors which contributed to this fall includes the FED indicating rate cut this year. Unlike other central banker which has cut rates earlier in the year and then paused, but FED looks to start rate cut cycle leading into next year. The quantum of rate cuts by FED as compared to other central banks is also a significant driver for the weakness in US dollar. Also concerns about the week labour market and rising US debt over past years has added headwinds to the weakness in dollar. The yield on US10Y continues to remain volatile where we saw c.13bps movement over the week.

US dollar falls to lowest level since Dec23 on rate cut prospect

September rate cut is done deal but the jobs report will determine the magnitude of cut

This week US job data will be crucial which may decide on quantum of September rate cut after recent weakness and downward revisions to payroll. The NFP data in August is expected to rise by 164k as against 114k in July. While the unemployment rate is expected to fall slightly to 4.2% form 4.3% in July. **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.** But the risk remains if we get sub 110k number on payroll while unemployment rate rises above 4.3% the FED might be prompt to cut by 50bps. Currently the CME FedTool shows market pricing in 30% probability of 50bps rate cut in September meeting.

Eurozone: Euro touched the level of 1.12 in August for the first time since July 2023 i.e. 2.25% gain in August the best month of the year, although it does not reflect an improved economic outlook and is primarily US dollar led outlook. German economy seems to be in trouble and since last few quarters it has been hovering between contraction and expansion zone. The election in Germany held on 01st September in which Germany's far right party Alternative of Germany (AfD) celebrate historic performance in the sate of Thuringia. The result is historic as it is the first time any right wing won in parliament since WWII. Meanwhile, France still has a caretaker government as Macron still needs to appoint a Prime minister who can secure majority in parliament to pass this year's budget. The market is currently pricing a quarter point rate cut in 12th September ECB meeting.

More bad news from German economy continues

IFO business climate continued to fall

Economic prospect worsens in Germany business climate continues to fall

The data over the week form Germany keeps the market worried about its economic prospect. The Germany's most prominent leading indicator IFO business climate fell from 87.0 to 86.6 in August continuing the downward trend as which does not bode well for the German economy. A look at the component shows decline in August is due to wore assessment of current situation while expectations have deteriorated further.

German economy fell back into contraction in second quarter

The second estimate of German GDP growth in the second quarter of the year confirms that the economy fell back into contraction, shrinking by 0.1% Q/Q, from 0.2% Q/Q between Q1. On Y/Y basis, GDP growth was up by 0.3%. While private consumption dropped by 0.2% on Q/Q and investments plunged by more than 2% Q/Q. Net exports were also a drag on growth.

German Inflation slipped below the 2% target, Euro area inflation also remains low.

Inflation in Germany below ECB's target of 2%

Inflation in Germany for the first time since March 2001 fell below the ECB's target of 2%. The headline inflation fell significantly from 2.3% in July to 1.9% in August. While the core inflation in August came in at 2.8% slight drop from 2.7% in July.

The main driver of the reduction was attributed to significantly lowering of energy prices. Food prices were 1.5% higher on YoY basis in month of August. The eurozone inflation plunged to three year low at 2.2% in August down from 2.6% in July.

Rupee advances on robust FPI inflows amid MSCI rejig:

After FED Chair Powell laid the ground work for Fed's action plans in the upcoming policy, Dollar has seen a sharp fall (DXY: 100.60) prompting surge in major global currencies. However, this week when USD was trading at lower levels, robust US data like USQ2 GDP and consumer confidence data have helped recovery in the greenback (DXY: 101.73). Unlike Asian peers, Rupee dampened and hovered close to its all-time low (On 06th Aug'24 @ 83.9850). The downside (vis-à-vis 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 move in Rupee was the weakest compared to other Asian peers. Our analysis for the last week of August shows all Asian currencies appreciated, while Rupee saw net depreciation this week.

Robust FPI inflows supported the INR

FX reserves remains at record high level

MSCI Global Standard Index, August Rejig has included 7 Indian stocks while excluded 1 in its index. This rebalancing is estimated to draw passive inflows worth $5.5bln in the domestic equity market. In this week, FPI flows gushed in the equity segment, $2816.01mln vis-a-vis inflows of $584.10mln a week ago, even the debt has seen a substantial increase of inflows of $785.95mln vis-à-vis $268.83mln a week ago. However, the appreciation in the local currency was capped amid month end Dollar bids from importers, oil buying and Dollar short squeeze as the inflows induced by JP Morgan EM bond index inclusion did not hit the market and hence dollar supply has taken a hit now.

Liquidity operations by RBI to absorb surplus liquidity amid FAR related inflows is done with increased pace of VRRR operation. Also, OMO sales by RBI continued for 7th consecutive week with a total sale of Rs 1,775crs in the week ended 23rd August & cumulative of Rs. 17,165crs. Our analysis shows the record high forex reserves kitty have gone up by $7.02bln to $681.69bln ($4.56bln estimated using reserves adjusted after valuation effects), signalling that the RBI has continued to beef up its accumulation strategy to buffer its reserves.

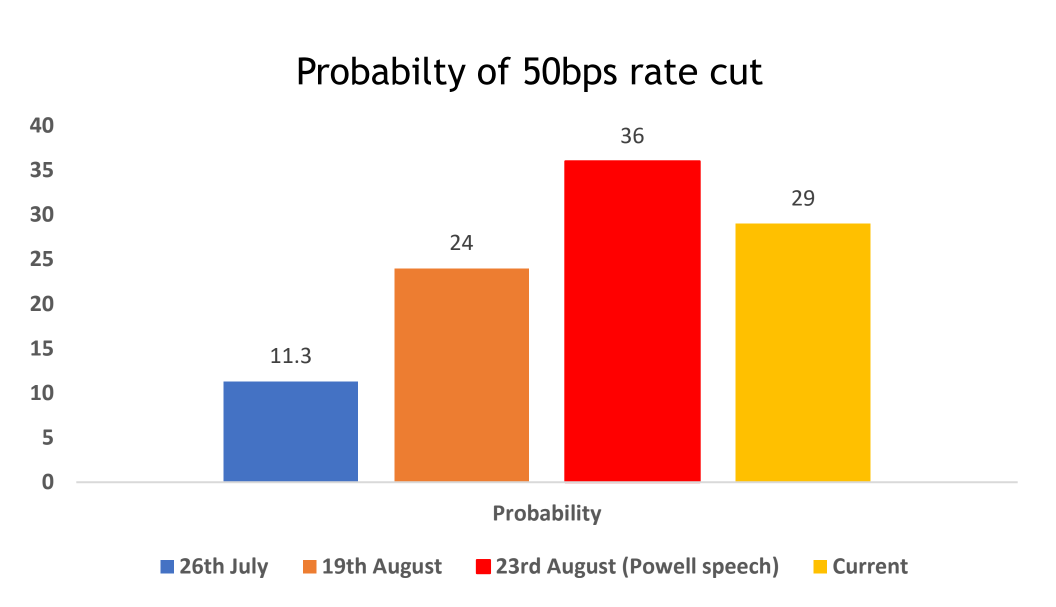
In the last week, US FED's preferred gauge PCE data stays on declining trend and has supported the Dollar (DXY: 101.73 from 100.68). India being a major oil importing country will be affected by any upticks in global crude oil prices, tensions in the middle east along with output cut in Libya will determine trend in Rupee movement. However easing oil losses on prospect of higher OPEC+ supply may support the domestic currency. Last week, INR traded in a narrow range with an appreciating bias from 83.8050 to 83.9700. For this week, we expect the domestic currency to remain relatively stable with a positive bias, in the wake of dollar inflows, however the last NFP data before next FOMC meet on September will be a major data print to look out for. We maintain our technical stance that INR should take support of 83.56 and will find a strong resistance around 83.98 levels, breach of which will test 84.16 levels (NDF highs).

Given our view that FED to start rate cut in September while RBI may delay its rate cut cycle, will lead to widening in interest rate differential. Assuming that the risk sentiment stays favourable. This is likely to open doors for more FPI flows in the coming months leading support to Rupee, as FED is expected to start cutting rates from its September Policy; while RBI will stay on its "Withdrawal of accommodation" policy stance due to higher food inflation.

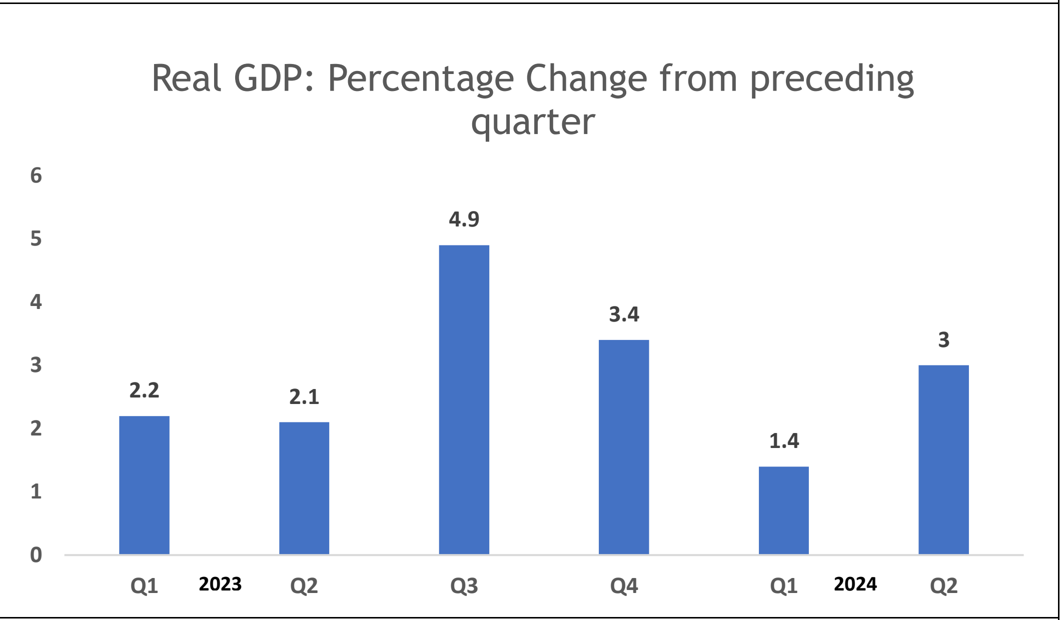
Next Week Economic Indicators

Date	Time (IST)	Country	Data	Month	Forecast	Previous
03.Sep.24	19:30	US	ISM Manufacturing PMI	Aug	47.5	46.8
04.Sep.24	07:00	AU	GDP Growth Rate (QoQ)	Q2	0.30%	0.10%
04.Sep.24	19:15	CA	BoC Interest Decision	Sep	4.25%	4.50%
04.Sep.24	19:30	US	JOLTs Job Openings	Jul	8.09M	8.18M
05.Sep.24	18:00	US	ISM Services PMI	Aug	51.4	51.2
05.Sep.24	18:00	US	Initial Jobless Claims	Aug	247k	231k
06.Sep.24	**18:00**	**US**	**Non-Farm Payrolls**	**Aug**	**163k**	**114k**
06.Sep.24	**18:00**	**US**	**Unemployment Rate**	**Aug**	**4.30%**	**4.30%**
06.Sep.24	14:30	EU	EZ Core CPI Flash (YoY)	Aug	2.80%	2.90%

The 50bps rate cut probability has decreased & currently stand at 29% (Fig 1)

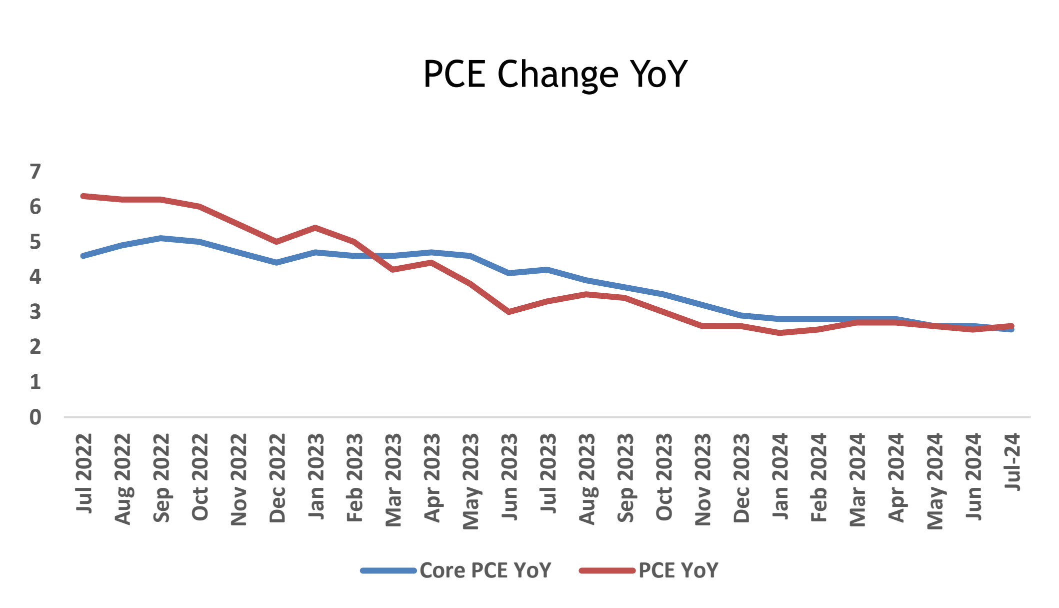


Consumer Spending lifts Q2 GDP Growth to 3% (Fig 2)

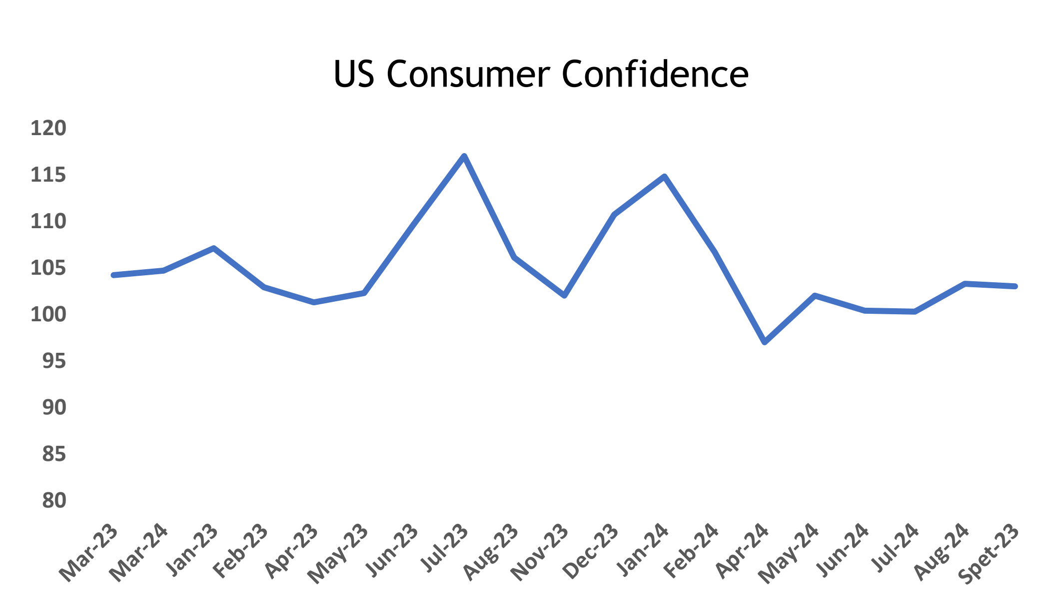


Source: Bloomberg, CME Fedwatch Tool, BLS.gov US

US PCE stays on declining trend *(Fig 3)*

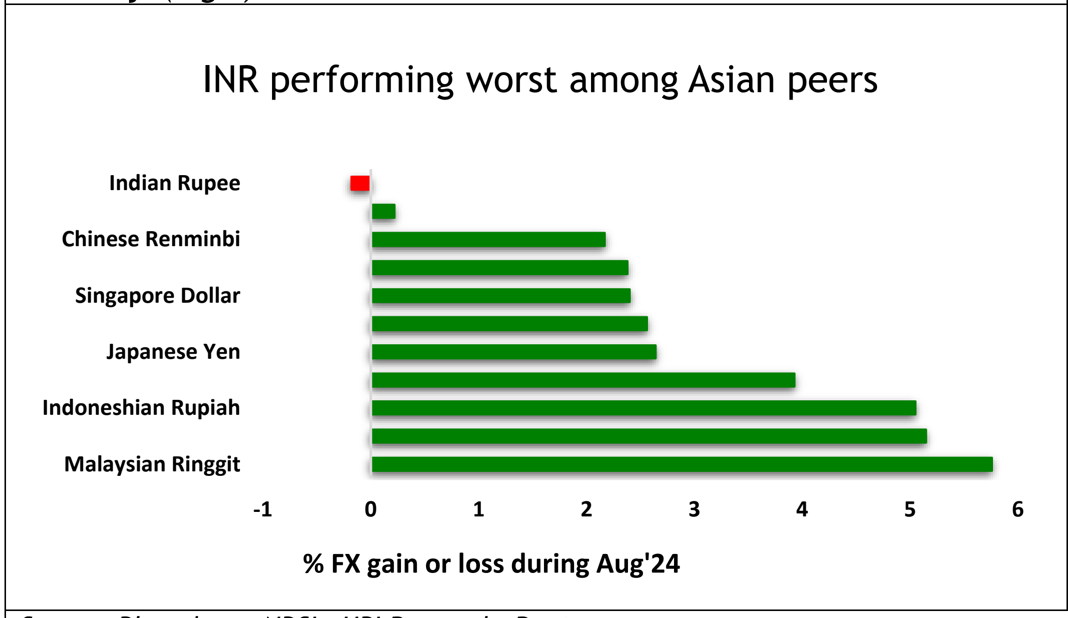


Consumer Confidence Index improved in August, but labor market outlook remains concern *(Fig 4)*

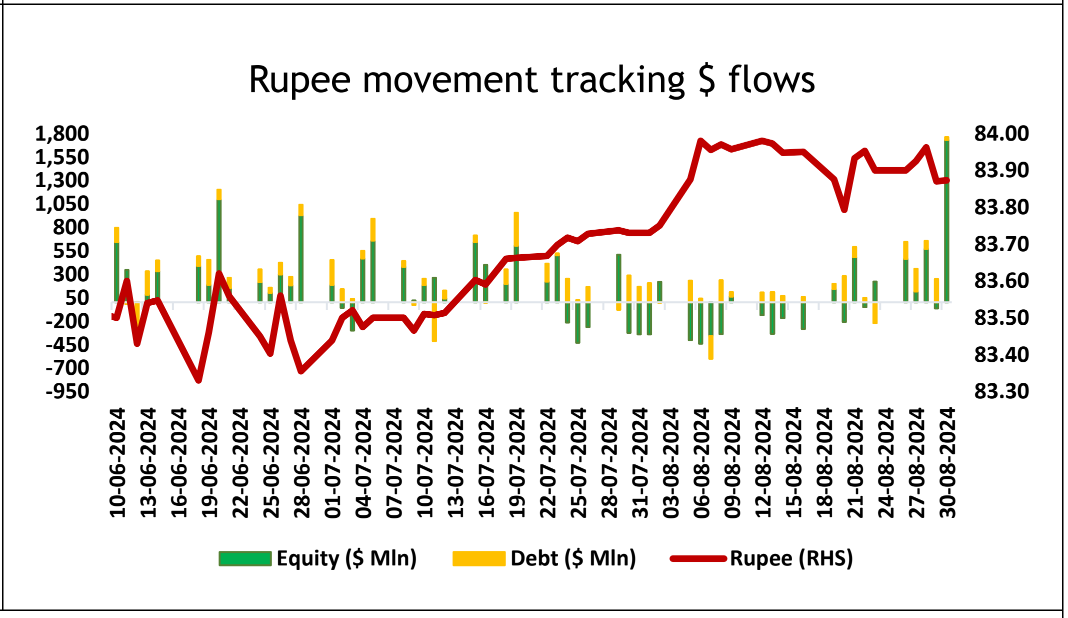


Source: Bloomberg, Reuters,

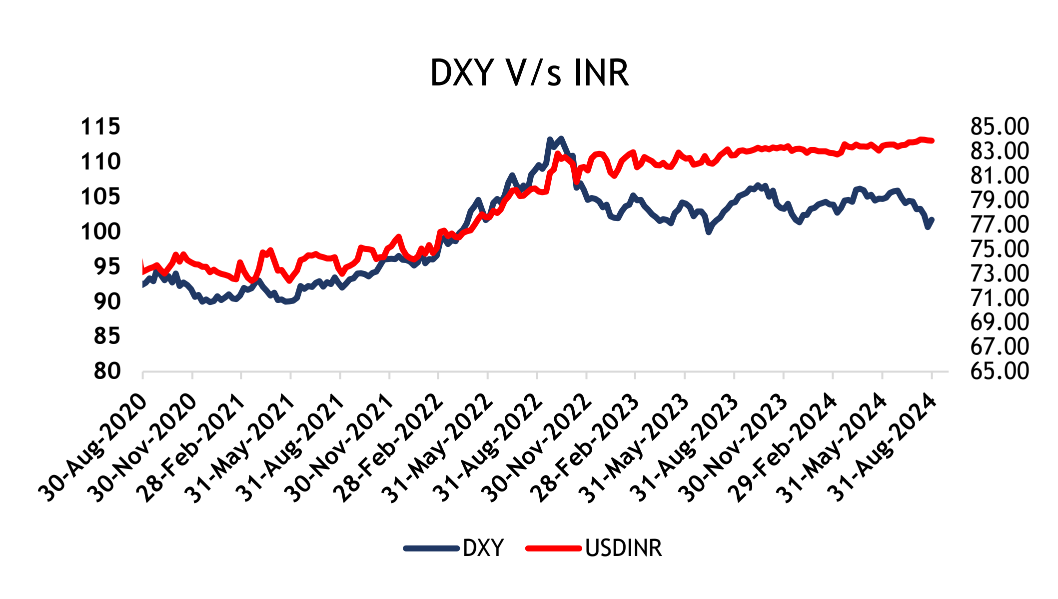
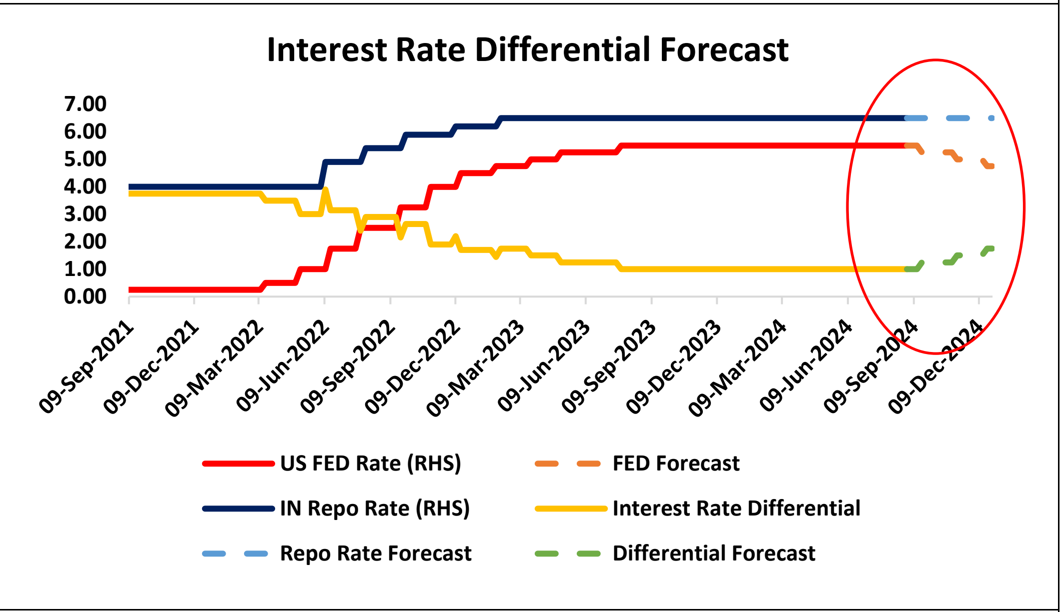
Despite US Dollar weakness Rupee remained worst performing currency (Fig 5)



Robust FPI inflows supported Rupee (Fig 6)



Source: Bloomberg, NDSL, UBI Research, Reuter

INR defies US Dollar moves (Fig 7)	Robust FPI inflows supported Rupee (Fig 8)
	
Source: Bloomberg, UBI Research, Reuter	

Banking Research Team	
Kanika Pasricha **Chief Economic Advisor**	**kanika.pasricha@unionbankofindia.bank**
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank