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FED signals start of rate cut cycle in September

Last week was central bankers' week where key policy rates were announced by three central banks. DXY continued its losing streak on monetary policy divergence between US and Japan, weak US jobs data and unwinding of carry trade. The hot money started to flow from equities to safe heaven currency like JPY & CHF and fix income markets amid recession fears in US after the recently released NFP and unemployment data which stayed above 4%. The yield on US10Y slipped to 3.70%, lowest since June'23 before recovering to 3.85% post strong US ISM services data. BoE for the first time cut its policy rate after keeping it at 16-year highs. (Pls refer: [Uni-Fx: Markets in Mayhem mode amid US recession fears & unwinding of carry trades](#))

The key FX theme for last week are outlined below. In this week, RBI monetary policy decision and any further development with respect to US presidential elections will be of key importance.

- ♣ **Weak Jobs data increased fears of recession in US**
- ♣ **BoJ hikes rate for second time, while announces reduction in bond buying program**
- ♣ **RBA maintains status quo in its monetary policy as inflation proving persistent.**
- ♣ **BoE cut rates with finely balanced decision as inflation stays under control**
- ♣ **Rupee hits all-time lows, RBI MPC meet will be in focus:**

Weak Jobs data increased fears of recession in US

The recently released July NFP data shows US added 114k jobs, sharply lower than expectations and the unemployment rate climbed back to 4.3%, highest since Oct'23. This led to selling in US dollar on increased probability of rate cut in September. The data from the CME FedWatch Tool shows market are now pricing in a nearly 77% chance the Fed will cut rates by 50 basis points in September, up from just a 6% chance a month ago. FED's Daly said the she is more confident inflation is on path to 2%, while July jobs report reflected a lot of temporary layoffs due to hurricane effect and if FED reacts to one data point, it would almost be always wrong. The recently released PMI data on 5th August showed US services sector rose in July, as the Services PMI went up from the previous month's 48.8 to 51.4, entering expansion territory and Composite PMI clocked at 54.3 in July, down from 54.8 in June. Following a drop in the July global manufacturing output PMI, a modest rise in global services PMI provided some comfort that economic growth is holding up. This led to recovery in US10Y yields by c.15bps, at the time of writing this report, it is trading at 3.87% levels.

Surging Popularity of Kamala Harris unwinds Trump Trades

The latest polls suggest Kamala Harris leading Trump with 54%-win probability. The surging popularity of Kamala Harris in recent US polls and increased odds of FED rate cut have led to unwinding of Trump trade. This is because markets were expecting the US dollar to strengthen on the backdrop of trade wars led risk aversion and expansionary fiscal policy as favoured by Trump. The market volatility is likely to persist with less than 100 days from now until the November 5, 2024, date for presidential elections.

BoJ hikes rate for second time, while announces reduction in bond buying program

The week saw JPY gaining strength by c.4.67% given the backdrop of BoJ hiking key rates and increased FED rate cut probability which led to unwinding of carry trades. Japan's MoF, FSA and BoJ held trilateral meeting on 6th August and emphasised that the government would monitor and analyse financial market moves and work closely with relevant authority, including with BoJ after sharp swings were witnessed in Japan's financial markets. In a dramatic turnaround for Japanese equities touching record high in July, TOPIX is down c.12% since the release of monetary policy.

At the monetary policy meeting, the BoJ raised the policy rate by 15bps to 0.25%, and announced the scheduled reduction in the BoJ's JGB purchases. There were two dissenting votes which called for a

Carry Trades starts to unwind as JPY appreciates on BoJ rate hike

postponement of the rate hike. BoJ decided to reduce its monthly JGB purchases by JPY0.4 trillion each quarter from the current JPY5.7trillion, reaching JPY2.9 trillion by Q1'26. The policy statement was hawkish compared with market expectations. BoJ clearly stated the possibility of additional rate hikes and scaling back the degree of monetary accommodation.

Squeeze on Yen carry trade causes panic selling among investors

The surge in the yen comes in the wake of the Bank of Japan hiking interest rates last week in a hawkish tone and a sharp unwinding of carry trades as investors rushed to get out of an appreciating currency. CFTC data last week showed speculators' bearish bets against the Yen have been slashed to \$6 billion from April's near-decade high of \$14.5 billion.

The yen came under heavy pressure in recent months as the wide gap between borrowing costs in Japan and those elsewhere meant it was a popular choice as a funding currency for carry trades. These investors borrowed in a currency where interest rates are low i.e. yen and then swap them for another currency in which they can invest in higher yielding assets (US dollar, Aussie). But with the BoJ raising rates to highest since 2008 at a time when central banks around the world are cutting rates, Yen's attraction as a carry trade currency has started fading. This shift could diminish the attractiveness of short yen positions, on narrowing rate differential between the BoJ and other central banks, particularly the Fed which is expected to start rate cut cycle from September. Similar to latest episode, in 1998, there were two consecutive days of 10 big figure moves in USD/JPY (6th Oct & 7th Oct). The year 1998 was the year of global currency crises where the US FED started its rate cut cycles and delivered three consecutive cuts. Similar Yen strengthening cannot be ruled out.

RBA kept its policy rate unchanged

RBA maintains status quo on its monetary policy as inflation proving persistent.

Reserve Bank of Australia kept the cash rate unchanged at 4.35% for the sixth straight meeting, as widely expected. After the decision, AUD traded steady against the US dollar and at the time of writing this report, it is trading at 0.6490 levels. RBA warned that Inflation is proving persistent and remains well above the target price of 2-3% range. The monthly CPI rose by 3.8% YoY in June, down from 4.0% in May, while core CPI clocked 4% in June, unchanged from May. The most significant price rises were in Housing which jumped by +5.5%

RBA Inflation remains above target and is proving persistent.

The outlook on inflation and growth remains highly uncertain.

RBA in its policy statement stated the economic outlook is uncertain and recent data have demonstrated that the process of returning inflation to target has been slow and bumpy. The central forecasts set out in the latest MP are for inflation to return to the target range of 2-3 per cent late in 2025 and approach the midpoint in 2026. Momentum in economic activity has been weak, as evidenced by slow growth in GDP, rise in the unemployment rate and reports that many businesses are under pressure. There is a risk that household consumption picks up more slowly than expected, resulting in continued subdued output growth and a noticeable deterioration in the labour market.

BoE cuts rate with finely balanced decision

BoE cut rates with finely balanced decision as inflation stays under control

The BoE cut rates 25bps to 5% in its 1st August meeting, in a very close 5-4 vote. Even among the five voting for a cut, the decision was described as "finely balanced. U.K.'s battle with weak growth and high inflation might be coming to an end just as an era of political turmoil and uncertainty was also potentially over. Governor Andrew Bailey stressed that the BoE was not at the start of a series of swift cuts, saying the stronger performance of the economy in recent months could keep inflation risks on the radar. While growth for 2024 was revised up from 0.4% to 1.2%, the underlying pace was characterized as softer.

Economic data remains mixed

UK Composite PMI rose to 52.7 in July from 52.3 in June. While manufacturing PMI rose to 52.1 in July, compared to 50.9 in June. Hopes for an economic revival and reduced political uncertainty took confidence to one of its highest levels for two-and-a-half years. Retail sales dropped 1.2% in June after rebounding 2.9% in May. UK unemployment rate held steady at 4.4% in May

Rupee becomes worst performing currency among Asian peers

RBI MPC meet outcome awaited

Rupee hits all-time lows, RBI MPC meet will be in focus:

July had been a highly volatile month where major global currencies witnessed huge rallies and tested multi month highs and retraced thereafter. The CME Fed-watch tool now shows 50 bps rate cut probability surged to 76% in Sep'24. Markets are 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; where the upside was mainly capped by strong dollar sales amid intervention fears by the central bank. The local currency kept elevated amid month end Dollar bids from importers, due to oil and gold buying (import duty was reduced from 15% to 6% in the union budget). RBI continued OMO sales for 3rd consecutive week with a total sale of Rs 3985crs in the week ended 26th July & cumulative of Rs. 10,125crs to absorb surplus liquidity amid FAR related inflows. Continuous dollar sales by major PSBs capped knee jerk depreciation in the domestic currency and a gradual weakening was noted. The record high forex reserves kitty fell by \$3.47bln (\$1.56bln drop was adjusted for valuation effects) and stood at \$667.39bln.

In this week FPI outflows continued in the equity segment, increased to \$280.60mln vis-a-vis from \$189.45mln was seen amid budget repercussion, while the debt has also seen a drop of inflows of \$575.48mln vis-à-vis \$657.38mln a month ago.

RBI MPC outcome is scheduled on 8th Aug'24 and we expect the central bank to maintain status quo on rates and stance (Refer our Report: [India - Conundrum between C-D Ratio and Real Rates](#)). On expectations of softer US rates, USDINR hedging costs are likely to shoot up amid interest rate differential. Also, equity meltdown fuelled risk off in the US (chances are increasing after weak labour data) ahead of US presidential elections (which has been the case of the past) then USDINR is likely to test fresh lows close to 84.16 mark (NDF high's).

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 likely strengthen US dollar on safe haven buying spree and drive depreciation pressure on Rupee.

Last week, while USDINR initially continued to trade in a very narrow range, the global market mayhem saw INR breakout from the consolidating range and tested psychological levels of 84.00. Interestingly, INR was the worst performing currency among the Asian peers. For the coming month, we expect the domestic currency to continue trading range bound, technically taking a support of 83.56 and will find a strong resistance above 84.16 levels.

This Week Economic Indicators						
Date	Time (IST)	Country	Data	Month	Forecast	Previous
07.Aug.24	11:30	EU	GER Industrial Prod. (MoM)	Jun	-2.50%	1.40%
07.Aug.24	11:30	UK	Halifax House Price Index (YoY)	Jul	1.60%	1.20%
08.Aug.24	10:00	IN	RBI Interest Rate Decision	Aug	6.50%	6.50%
08.Aug.24	10:00	IN	Cash Reserve Ratio	Aug	4.50%	4.50%
08.Aug.24	18:00	US	Initial Jobless Claims	Aug	249K	247K
09.Aug.24	11:30	EU	GER Inflation Rate (YoY)	Jul	2.20%	2.30%
09.Aug.24	17:00	IN	Foreign Exchange Reserves	Aug	\$667.39B	-

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