02nd Sept 2024- 09th Sept 2024

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Last week markets were searching for an answer on the quantum of a rate cut at the September FOMC meeting after J Powell indicated rate cuts along with other FED members. But the August jobs report did little to settle the debate if a 25 bps or 50 bps rate cut is coming this month. While our friends in the US have been iterating the FED will do front loading of 50bps in September meet, we continue with our stance that the FED is likely to follow a gradualist approach and will cut rates by 25bps cut in the 17-18 September meeting.

The Bank of Canada yet again cut its policy rate by 25 bps last week, for 2nd time citing downside risks to growth and an overall slowing in inflation. The central bank also signalled further easing, though given lingering concerns around elevated services inflation and wage growth.

The key FX themes from last week are outlined below. Coming week all attention will shift towards the US August CPI, European Central Bank Rate Decision (ECB) along with the debate between Presidential candidates Kamala Harris and Donald Trump will be closely watched. (**Pls refer**: Uni-Fx: Markets in Mayhem mode amid US recession fears & unwinding of carry trades)

- ♣ **Is August NFP data understating the US economy**
- ♣ **UST Yield curve spread has turned positive post NFP release**
- ♣ **ECB likely to cut for second time post June**
- ♣ **Rupee hit all-time lows; remains worst performing FX currency among Asian peers**

Is August NFP data understating the US economy

The BLS continues its downward revision in NFP data indicating weakness in labor market

US Nonfarm payrolls grew by 142K in August, a bit weaker than the consensus forecast of 165k gain but there were 86k of downward revisions in the past two months. June was initially reported at 206k, to be revised to 179k last month, and now is just 118k, while July was revised down to 89k from 114k. This month's downward revision by BLS in NFP data by 818k over the year further indicates the labour market was weaker than initially thought

This downward revisions to job data in the prior two months pushed the three-month moving average for nonfarm payroll growth down to 116K. This marks a notable deceleration from the average monthly job growth of 207K in the first half of the year and 251K in 2023.

Employment growth continues to be led by hiring in industries such as health care & social assistance (+44K), leisure and hospitality (+46K). Construction employment also posted a strong 34K increase in the month, but elsewhere hiring was slow with just an 8K increase for professional and business services and contraction in manufacturing (-24K), retail trade (-11K) and information (-7K).

Positive factor in labor data was slight reduction in unemployment rate

As expected the unemployment rate for month of August decreased by a tenth of a percentage point to 4.2%. Under-employment continues to move up as well, with the U6 unemployment measure, which includes people who are working part-time but would like full-time work, rising to a new cycle high of 7.9%. Average hourly earnings grew more than expected in August, was up 0.4% over the month and 3.8% over the past year. The Sahm Rule recession indicator, at 0.57, is still above the historical threshold associated with a recession.

Rate Cut at Sept. FOMC Meeting: 25 or 50 bps?

Market still divide on quantum of September rate cut by FED

The CME FedWatch tool is currently indicating a 30% probability of a 50bps rate cut in this month's FOMC meet which fell significantly from 50% seen immediately after the release of Friday's labor data, while 25bps rate cut is fully priced in the market continues to price c.110bps cut by the end of 2024.

We feel that the FED would not prefer to cut by 50bps this month as it will send a signal to the market that the FED is behind the curve. We continue to stick with our 25bps cut this month while attention is already turning to this week's CPI report for further clues which on YoY basis is expected to fall to 2.6% in August vis-à-vis 2.9% in July.

UST Yield curve spread has turned positive post NFP release

US 2Y/10Y yield curve turns positive

For over two years, the US Treasury yield curve spread (2Y vs 10Y) has been inverted. Normally, if you lend money for a longer duration, you expect to get more interest. But for the last two year, it was the opposite as markets were worried about growth concerns in medium to long term. Short-term bonds were getting more interest than long-term ones. This flip-flop is called a yield curve inversion.

However, this expectation has eroded in recent months with growth slowdown worries as near-term policy easing has come into focus. With inflation now well on the road towards 2% comfort level and the labor market slowing, FOMC members have highlighted that focus is shifting on balance of risks and its willingness to ease restrictive monetary policy.

Before 2019, a negative 10Y vs 2Y spread was broadly consistent with the onset of a recession within two years. However, it was the subsequent positive resurfacing of the spread that was more closely linked with the timing of the onset of a recession. For example, in 2007, when the spread between the 10Y and 2Y Treasuries had been negative for nearly a year before decisively turning positive in June 2007. The start of Great Recession began only six months later in December 2007.

Since the beginning of last week, the 2Y moved more than 25bps lower. The 2Y & 10Y turned positive by 2bps last week where we saw one of the longest yield curve inversions in the history marking the bond traders consider the start of deep rate cutting cycle by FED as the curve has been steepening.

Trump and Kamala Harris face off this week on close watch

US presidential election appears to be close contest

The US Presidential candidates are set for a face off for the first time on 10th September. While the polls from Predict-It suggest that Kamala Harris has 53% winning odds against 50% for Donald Trump. While the election appears to be a close contest.

Markets will be watchful of any commentary on policy stance by both the candidates. As Trump has been advocating universal 10% tariff on imports and to raise tariffs on goods from China to 60%. While Kamala Harris has backed tariffs only on certain Chinese imports such as 100% tariff on electric car and 50% on solar panels. Moreover, Trump has pledges to impose 100% tariff for the countries which are moving away from the US Dollar (countries attempting De-dollarization). While India is unlikely to be affected by this trade war as US and India share a deep economic and strategic interest. And US also sees India as its strategic partner to counter China.

ECB likely to cut for second time post June

Economic prospect continues to worsens in Germany and may prompt ECB to cut this week

The European Central Bank announces its monetary policy decision this week, at which it is widely expected to deliver further monetary easing a 25bps reduction in the deposit Rate. The ECB's updated economic projections will also be closely watched.

Recent economic data, while mixed, has been subdued overall, supporting the case for ECB easing this month. The data from the largest economy in the Eurozone i.e. Germany indicates a gloomy picture where the second estimate of German GDP in Q2'24 confirmed that the economy fell back into recession zone. Also leading indicator IFO business climate continues to fall. On eurozone there has been some encouraging news on the inflation front, as headline CPI slowed to 2.2% YoY in August.

Rupee hit all-time lows; remains worst performing FX currency among Asian peers:

After the much-awaited last key data point before US FOMC rate decision, NFP has somewhere dampened the probability of a 50bps rate cut. After the previous NFP print was revised downwards, Dollar weakened in a knee jerk reaction but recovered immediately as the latest data showed improvement in labor market dynamics (DXY: back to 101.45 from lows of 100.59). Even the US10Y softened to 3.65% levels but recovered back to 3.75% levels, thereafter FX crosses did not see much change after the data. Unlike Asian peers, Rupee dampened and hovered close to its all-time lows (On 05th 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 lowest compared to other Asian peers & more importantly the downside was capped.

In the last fortnight of August rejig of the MSCI Global Standard Index, the rebalancing was estimated to draw passive inflows worth $5.5bln in the domestic equity market. While majority of the flows were clocked last week yet INR was supported by FPI flows (in the equity segment) which moderated to $1308.84mln vis-a-vis inflows of $2816.01mln a week ago, however the debt has seen a marginal increase of inflows (majorly in the FAR segment) of $909.24mln vis-à-vis $785.95mln a week ago.

Liquidity operations by RBI to absorb surplus liquidity amid FAR related inflows is done with increased pace of VRRR, also RBI – Weekly Statistical Supplement – Extract showed the OMO sales continued for 8th consecutive week with a total sale of Rs 1,080crs in the week ended 30th August & cumulative of Rs. 18,248crs. Our analysis shows the record high forex reserves kitty have further inched up by $2.30 bln to $683.99 bln ($4.55 bln rise was adjusted after valuation effects), signalling that the Central Bank has continued to boost its reserve accumulation strategy to avoid any unforeseen future volatility in the domestic currency.

Moderate FPI inflows supported the INR

India being a major oil importing country will be affected in any upticks in global crude oil prices, tensions in the middle east, output cut in Libya along with OPEC decision to pause output hike supported the crude prices. However, amid concerns over weak demand growth in China, oil prices plunged to lows since Dec'23(Highs of $77.63/bbl to Lows of $70.61/bbl, Current level: $72.01/bbl), domestic oil companies rushed to purchase crude at lower levels weakened the rupee. Also, NDF related Dollar demands led to pressure on INR. However, the appreciation in the local currency was capped amid Dollar bids from sharp spike in oil buying on account of lower prices and Dollar short squeeze as the inflows induced by JP Morgan index inclusion did not hit the market and hence dollar supply has taken a hit now.

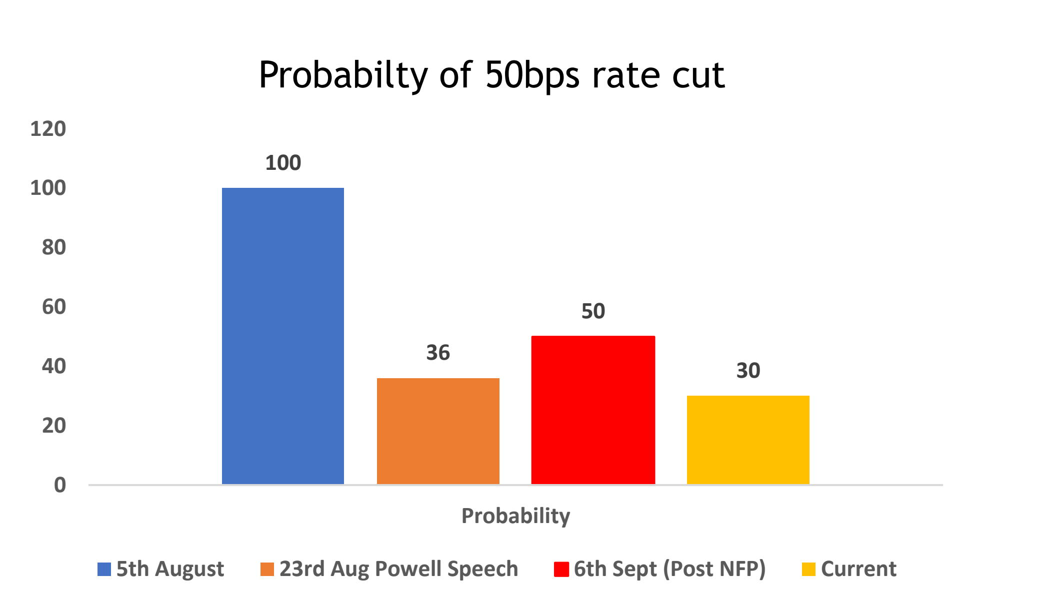
FX reserves continues to rise to clock to fresh record high

Last week, INR traded in a narrow range with a depreciating bias from 83.85 to 83.99 (All time low). For this week, we expect the domestic currency hovering at current levels with a positive bias, moderately supported by FPI dollar inflows. 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).

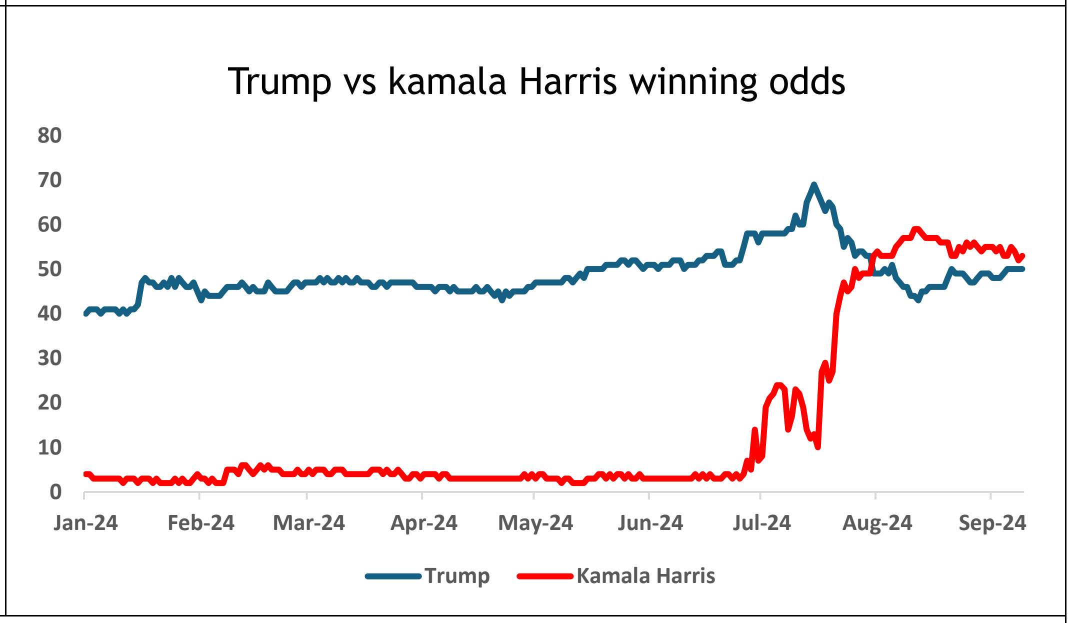
In the medium-term, the rise in interest rate differential between US & India is likely to open doors for more FPI flows in the coming months leading support to Rupee, as FED is expected to start cutting rates from this month; while due to higher food inflation RBI is expected to continue its "Withdrawal of accommodation" policy stance with relatively strong growth to provide policy to delay rate cut.

Major Economic Indicators						
Date	**Time (IST)**	**Country**	**Data**	**Month**	**Forecast**	**Previous**
10.Sep.24	11:30	UK	Unemployment Rate	Jul	4.20%	4.20%
11.Sep.24	11:30	UK	GDP (MoM)	Jul	0.00%	0.20%
11.Sep.24	18:00	US	Inflation rate (YoY)	Aug	2.60%	2.90%
12.Sep.24	17:45	EU	ECB Interest rate Decision	Sep	4.00%	4.25%
12.Sep.24	18:00	US	PPI (MoM)	Aug	0.10%	0.10%
13.Sep.24	19:30	US	Michigan Consumer Sentiment	Sep	67.4	67.9

50bps rate cut probability has decreased & currently stand 30% (Fig 1)



Current winning odds of Kamala Harris stands at 53% (Fig 2)

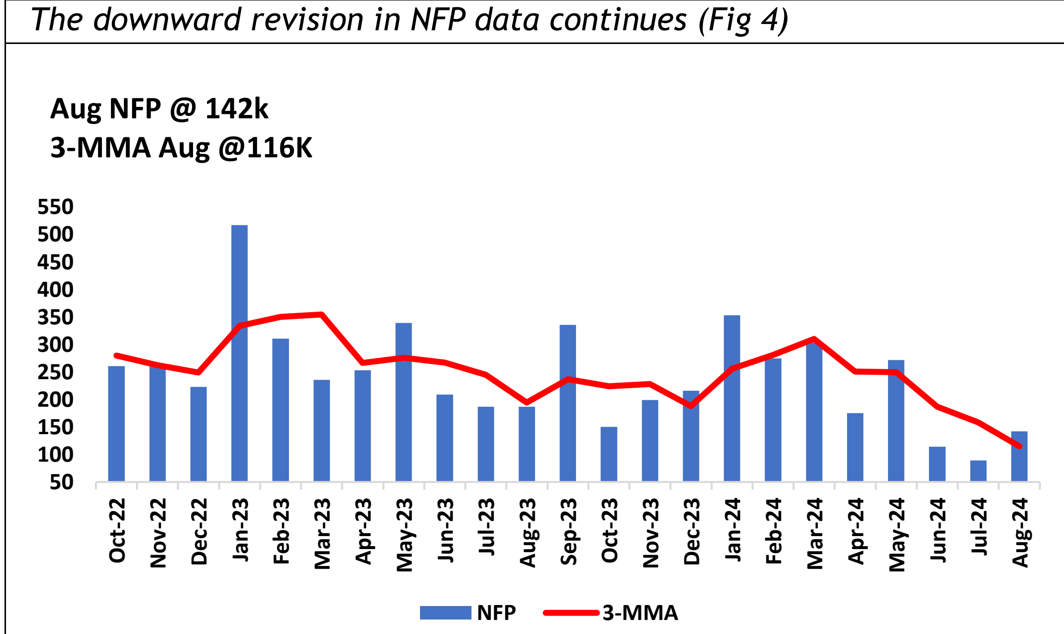


Source: Bloomberg, CME Fedwatch Tool, UBI Research, Predict-IT

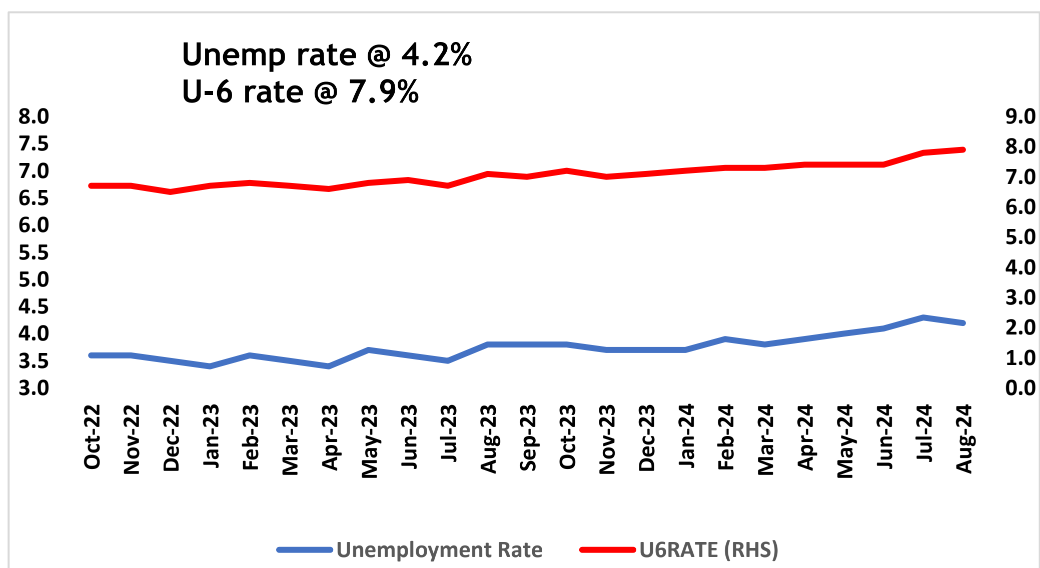
US 10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity (T10Y2Y)/The curve has currently dis-inverted by 5bps (Fig 3)

Source: UBI Research, FED St Louis

The downward revision in NFP data continues (Fig 4)

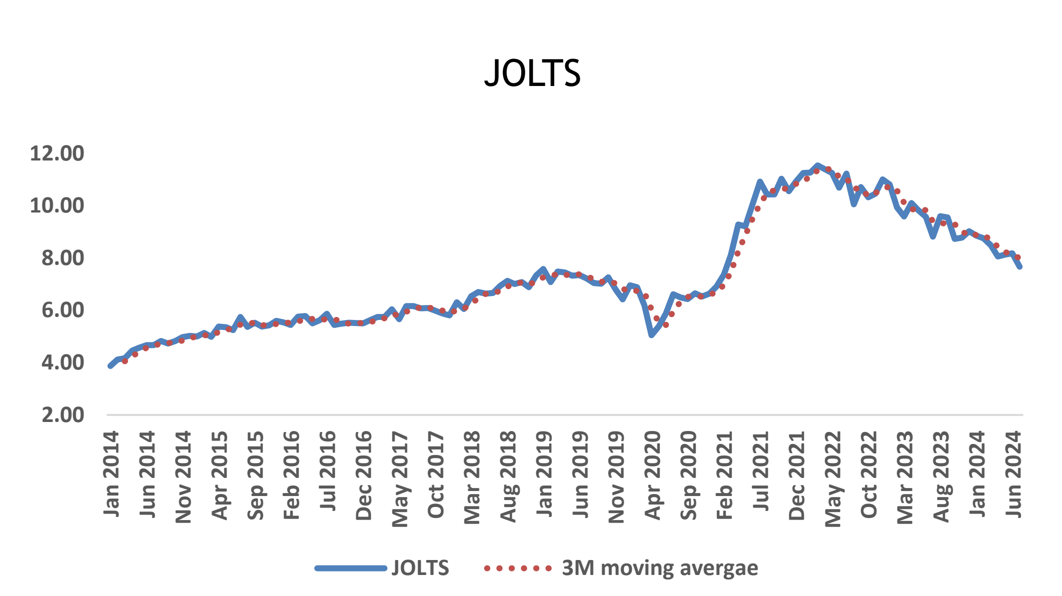


Unemployment rate slightly reduced to 4.2% in August (Fig 5)

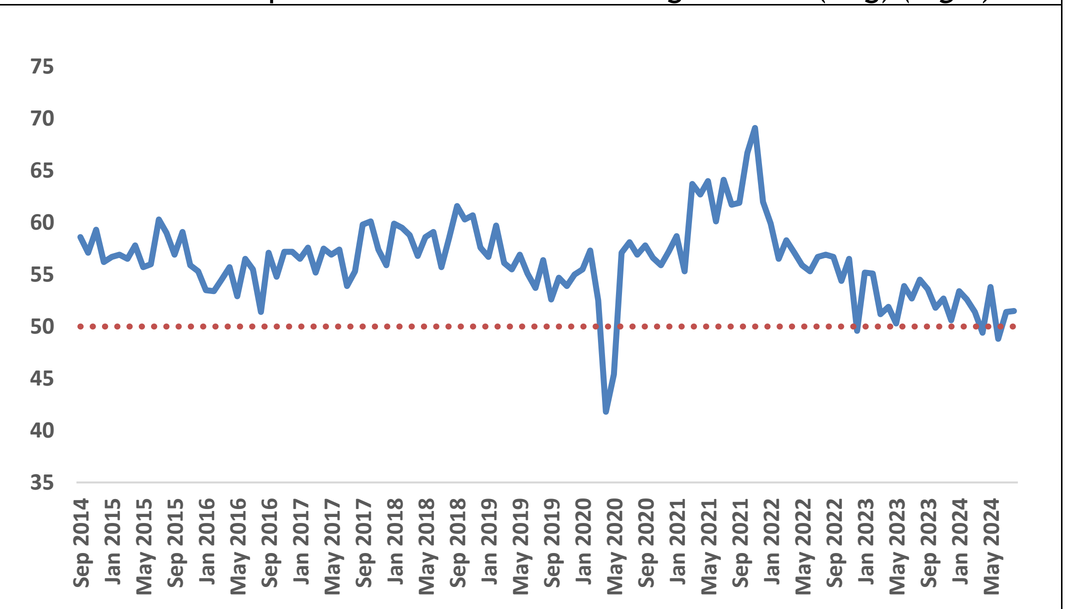


Source: Bloomberg, NDSL, UBI Research, Reuter

US JOBS Openings (Millions) @ 7.7M July, 3M Avg. @ 7.9MJuly *(Fig 6)*

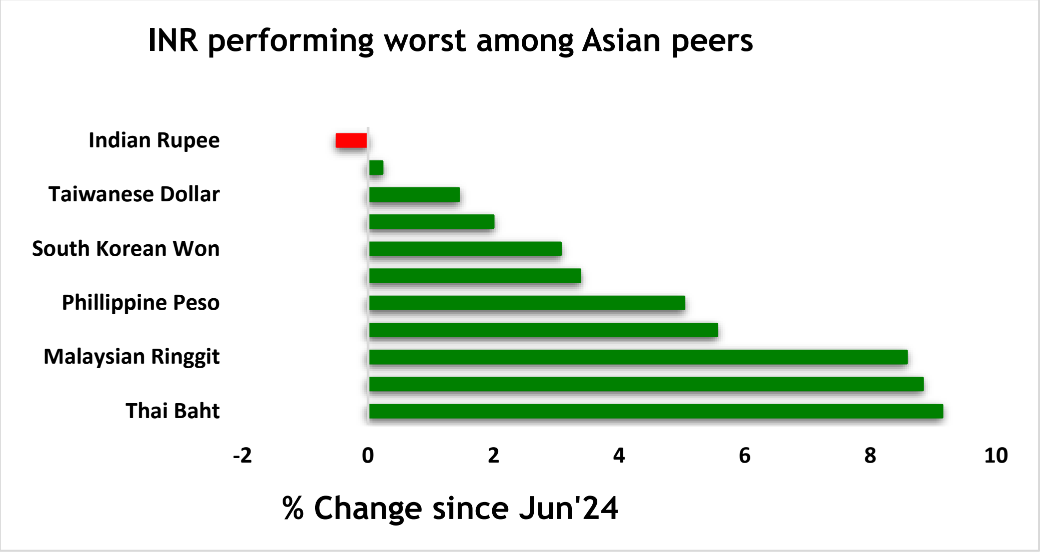


ISM Services Composite Index three month high @ 51.5 (Aug) *(Fig 7)*

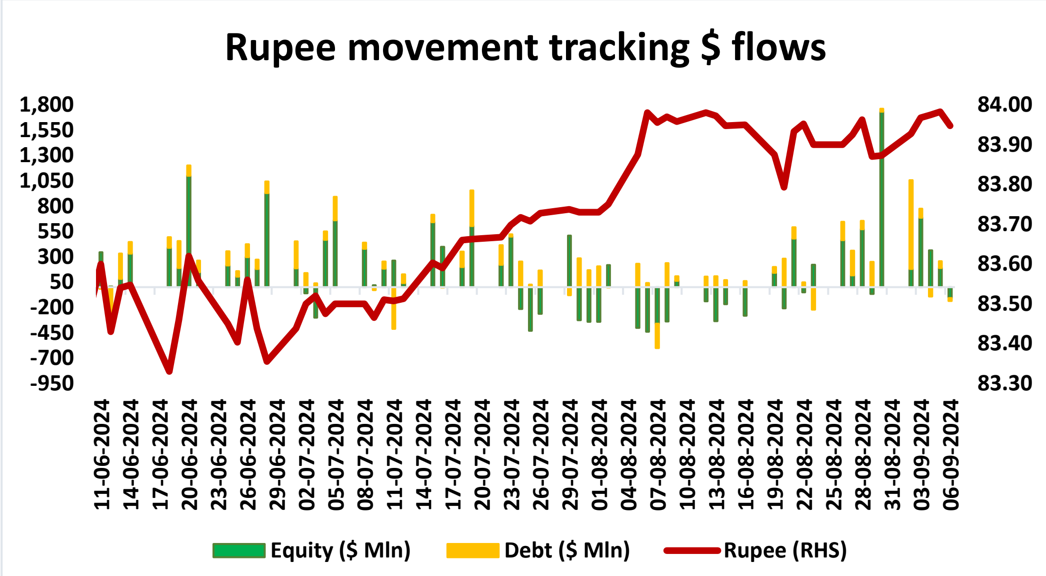


Source: Bloomberg, Reuters,

Despite US Dollar weakness Rupee remained worst performing currency (Fig 8)

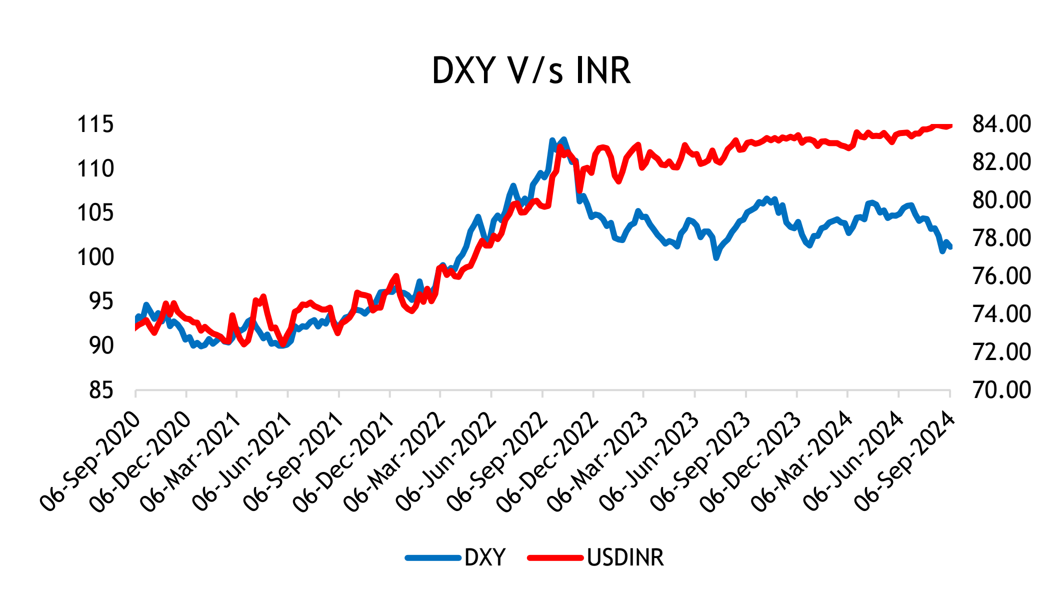


Moderate FPI inflows supported Rupee (Fig 9)

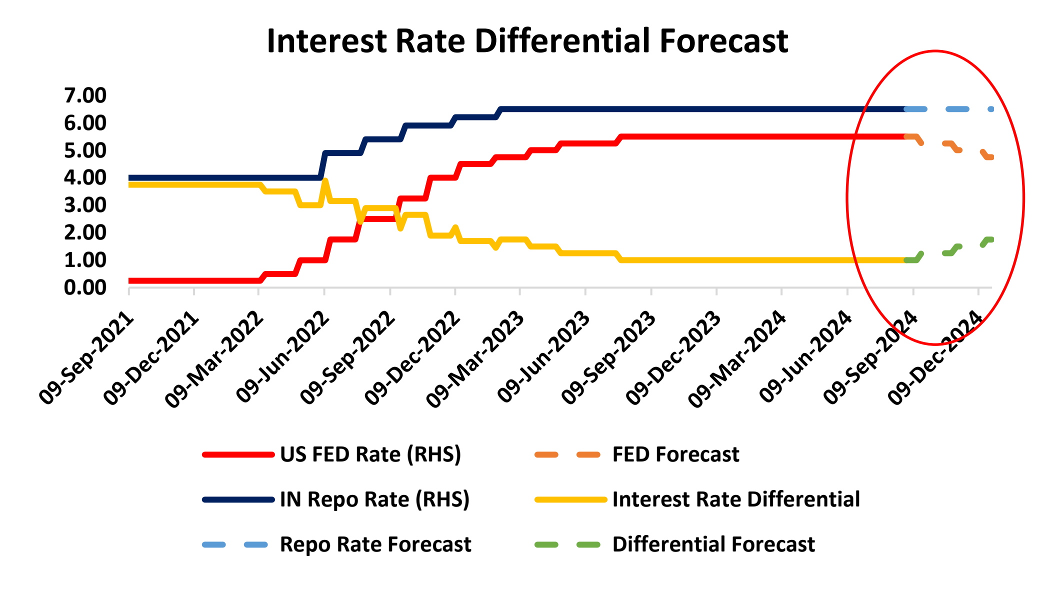


Source: Bloomberg, NDSL, UBI Research, Reuter

INR defies US Dollar moves (Fig 7)



Fed to cut this month interest rate differential to increases (Fig 7)



Source: Bloomberg, UBI Research, Reuter

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