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Global equity markets are in free fall since the publication of US jobs data on 2nd August, which raised US recession fears and unwinding of carry trades after BoJ hiked rates to highest since 2008. Consequently, investors rush for cover in fixed income market. The US Dollar currently showing weakness, but might hold its strength amid safe haven flows. As per our last published [UniFX-june24](#) report where talks were for Nov'24 rate cut has now been transformed to talks of 50bps cut in September FOMC meeting due to significant cooling in the job market where unemployment rate remains above 4%. The US 10-year treasury yield fell to its lowest at 3.70% since July 23, while TOPIX fell 19% of which 12% loss seen on 5th August (worst since 1987 Black Monday).

The other central bankers like ECB after first rate cut in June has maintained non-committal approach, BoE has cut rates by 25bps its first in four years, while on other hand BoJ has continued its rate tightening cycle which has sent jitters in the market. The antipode Australia is yet to start its rate cut cycle as it struggles with high inflation. In Asian countries like China in a surprise move have cut across all tenors, while its neighbour India is still maintaining higher for longer rates approach.

The key FX themes for Uni-Fx are outlined below.

- ♣ Weak Jobs data strengthens 50bps FED rate cut probability
- ♣ BoJ pulls the trigger for second time as deflation paves way for rate hike cycle
- ♣ BoE cut rates with finely balanced decision as inflation stays under control
- ♣ ECB maintains status quo in monetary policy, September move “wide open”
- ♣ Yuan gains amid intervention fears and increased bets of FED rate cut
- ♣ Rupee trading against the tide at record lows

Global equity market in free fall since the deep negative surprise in US employment data.

The global equity market is undergoing broad-based selling while bond is rallying, driven by mounting recession fears in the US and escalating tensions in the Middle East. The rapid move in the yen is putting downward pressure on Japanese equities, but it's also driving an unwind of a major carry trade. Investors had leveraged up by borrowing in yen to buy other assets, mostly U.S stocks.

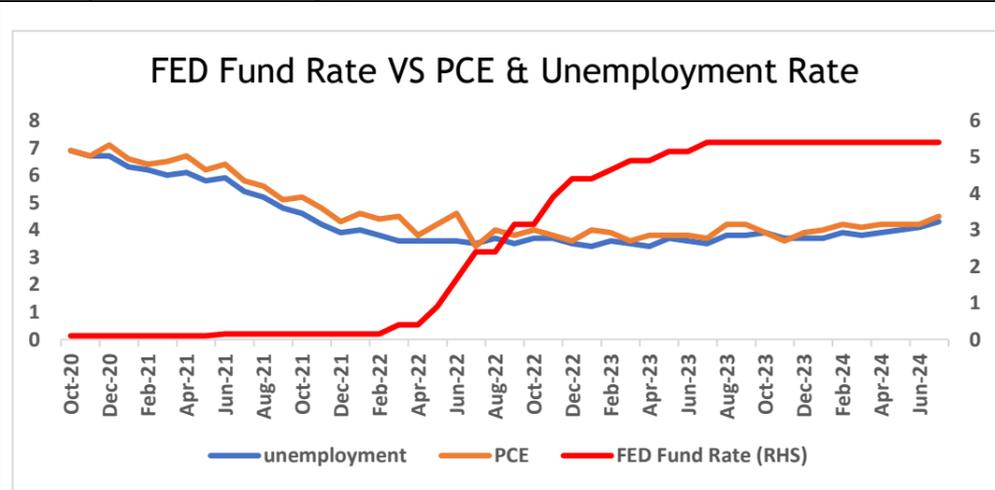
The DXY has fallen c.1.5% since July's peak on concerns that FED may be behind the curve. We feel that this is short term correction subsequently the US Dollar will gain strength due to potential safe heaven flows as can be seen in JPY & CHF. The data from the CME FedWatch Tool shows market are now pricing in a nearly 97% chance the Fed will cut rates by 50 basis points in September, up from just 6% chance a month ago.

Weak jobs data strengthens FED rate cut probability

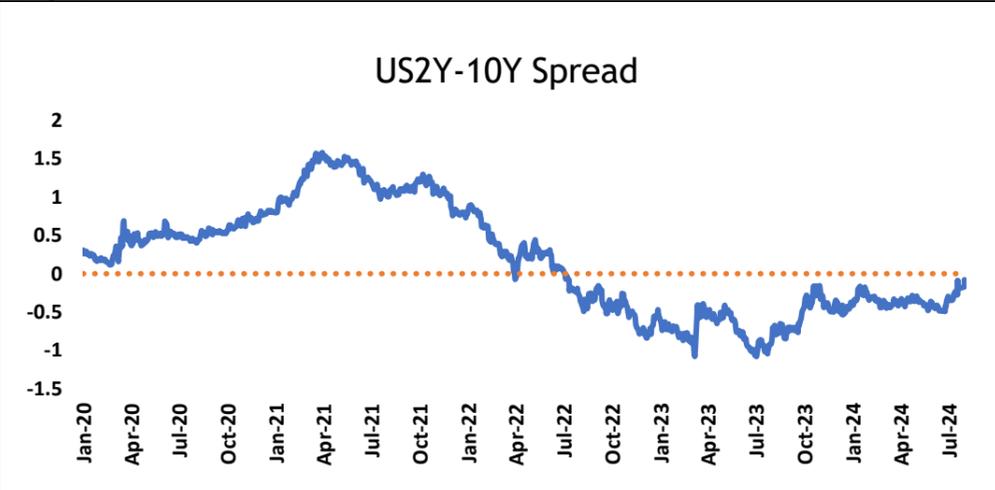
The recent signs of cooling labour market are raising fears of that the FED may have waited too long

Is US heading for hard landing?

July NFP data shows need for FED to cut rates at faster pace than anticipated earlier (Fig1)



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



Source: Bloomberg, UBI Research

Cooling US job market and fears of recession might prompt FED to cut at faster pace

US Yield curve closest it has been to turning positive since the inversion started

FED signals start of rate cut cycle in September

to lower its rate. The recently released July NFP data shows US added 114k jobs, lower than expected. While the unemployment rate again climbed back to 4.3%, highest since Oct'23. The business activity in the US manufacturing sector continued to contract at an accelerating pace in July, with the ISM Manufacturing PMI declining to 46.8 from 48.5 in June.

Trigger of Sahm Rule increases recession fears

The recently release jobless rate triggered the so-called Sahm rule, a historically accurate indicator of recession. The indicator has given the signal of recession first time after covid. The rule identifies information related to start of inflation when the three-month moving average of unemployment rate rises by 0.50 percentage point or more relative to its low during the previous 12 months. The indicator rose to 0.53 percentage points after the recent unemployment data.

US Yield Curve nears flip; recession signal not clear

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.

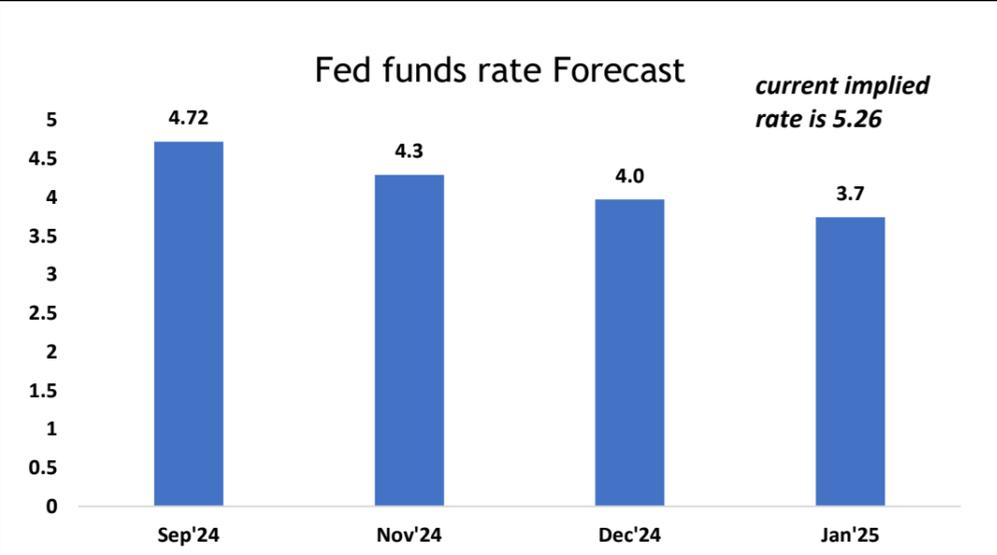
Since July 2022, the yield curve has been inverted i.e. the near-term yields are higher than those of longer tenor, indicating concerns over the economy. The steepness of the yield curve is a reflection of market expectations regarding economic growth, interest rate movements and inflation. After the release of July NFP and unemployment data which showed the deterioration in labor market that had so far shown surprising resilience during the Fed's aggressive rate-hike campaign. The 2-10 yield curve, which has been continuously inverted for more than two years, was at minus 3 basis points. **This is the closest it has been to turning positive since the inversion started in July 2022.** Hence the current move in yields is not providing a recession signal in contrast with the Sahm rule.

July FOMC meet signals September rate cut on the table

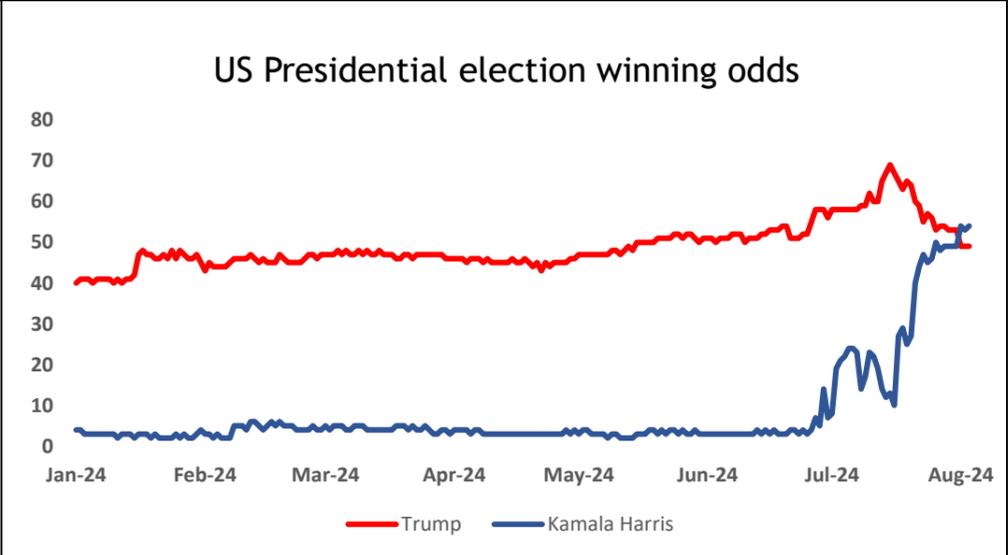
The Federal Reserve maintained status quo in its July meeting and kept benchmark rate unchanged at 5.25% - 5.50%, but signalled for a possible rate cut in September. The FOMC statement mentions that "inflation has eased over the past year but remains somewhat elevated".

FED Chair Powell's speech after the release of the FOMC's report further detailed on the committee's shift from focusing primarily on inflation to balancing their focus between inflation and the effect higher rates have had on the job market. Economy has made a real progress on its gliding path to reduce inflation to 2% and some downturn in the labour market would be responded. He stated that a scenario of zero cuts to several cuts is possible now depending on how the economy evolves. As per Powell, there was a real discussion around reducing rates in this meeting and signalled September rate cut is on the table, although a 50 bps was not something the committee is thinking about.

FED rate cut probability; shows 97% probability of 50bps cut in Sept FOMC (Fig 3)



Recent polls predict Kamala Harris leading with winning odds at 54% while Trump at 49% (Fig 4)



Source: Bloomberg, UBI Research, PredictIT, CME Fedwatch Tool

Kamala Harris leading Trump in recent polls

The road to 270, Trump Vs Harris matchup:

Less than 100 days from now until the November 5, 2024 presidential election. The latest polls suggest Kamala Harris leading Trump with 54%-win probability. The surging popularity of Kamala Harris in US polls and increased odds of FED rate cut have led to unwinding of Trump trade. As 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. 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 in the global market. However, this could undermine the dollar's status as world's dominant currency. He outlined that the expansionary fiscal policy by reducing tax rates while acknowledging that a 1% cut to corporate tax was more likely and increased spending on infrastructure. Trump has called for 60% tariff hike on imports from China. Although Trump wants dollar to be weakened but his policies which are inflationary will kept the US dollar supportive.

Jackson Hole meeting in focus

Going forward, the Jackson Hole meeting is scheduled to take place from Aug 22-24. When central banks across the world gathers, which typically features a keynote speech from Federal Reserve Chair Jerome Powell. This will give more insights on the monetary policy going forward and will be closely watched by market investors.

JAPANESE YEN (¥ - JPY)

BoJ pulls the trigger for second time as deflation paves way for rate hike cycle.

The Bank of Japan is setting the stage for an era of steady interest rate hikes by claiming victory in its long battle with deflation. This is the highest rate since 2008. Under Kuroda's stimulus deployed in 2013, the BOJ sought to shock the public out of a deflationary mindset with huge money printing and achieve its 2% inflation target in roughly two years. What the experiment failed to achieve was ultimately accomplished by external factors like supply constraints caused by the pandemic and the Ukraine war, which pushed up import costs and kept inflation above 2%.

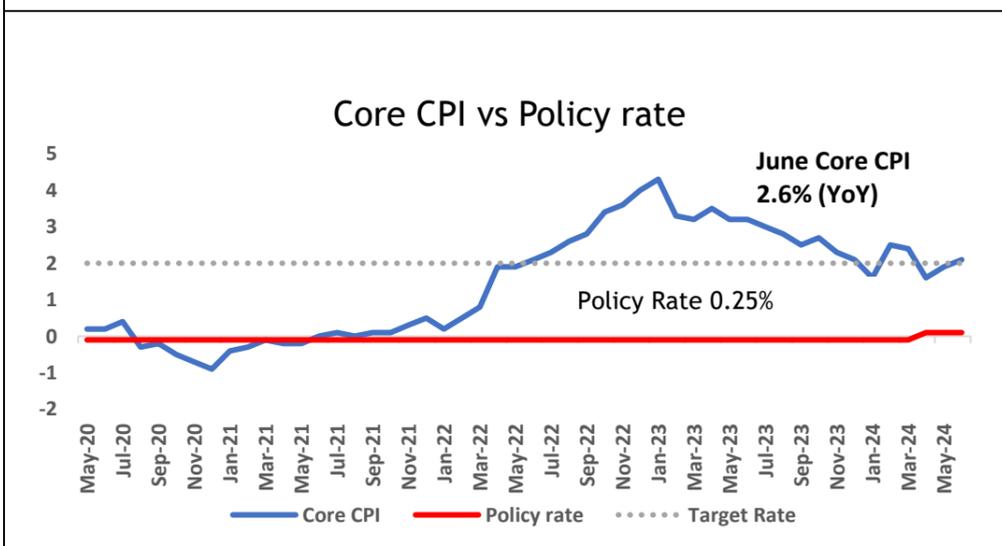
BOJ remains hawkish even the economic data remains weak.

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

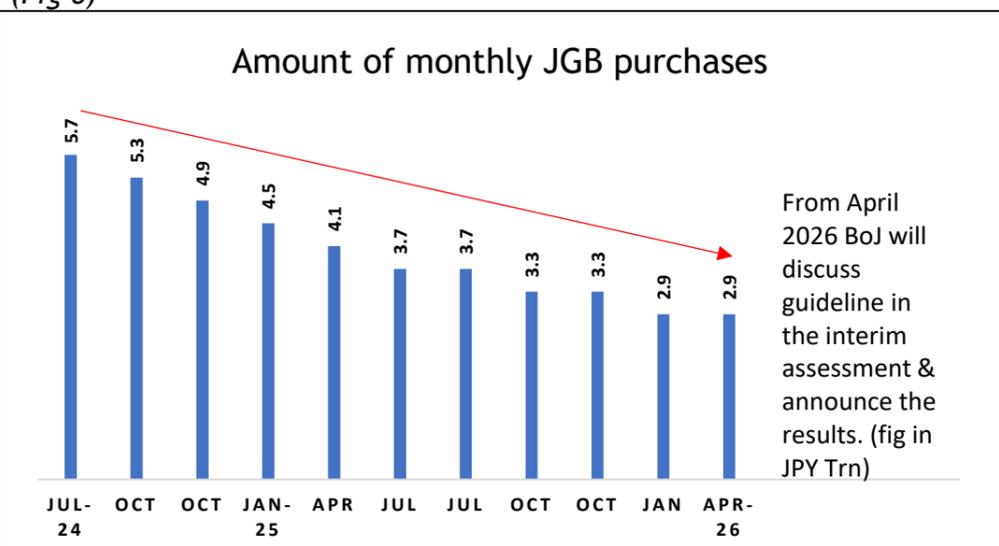
At the press conference, Governor Ueda echoed the policy statement, sending a clear message that the BoJ likely will continue to deliver rate hikes at a gradual pace. He repeated that BoJ's assessment that the current monetary policy settings are very accommodative even after the rate hike. He even stated that the policy settings will likely remain accommodative even after a few

BoJ continues its rate hike cycle and maintains hawkish stance

BoJ continues its rate hike cycle maintaining its hawkish stance (Fig 5)



BoJ announced cut in Bond buying program, reduce to JPY 2.9trn Q1'26 (Fig 6)



Source: Bloomberg, UBI Research, BoJ.org

Carry Trade unwinding strengthen the Yen

Money flows out of stock market as JPY hikes its policy rate.

more rate hikes, mentioning that the policy rate of 0.5%, which the market is focusing on, is not the level that the BoJ sees as a limit.

The recent released data by CFTC on 19th July shows speculators increased bearish bets on US 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 in bearish bets on the front end reflect a steepening yield curve.

BoJ Shift causes reassessment of Popular carry trade

The Bank of Japan's move to raise interest rates to their highest level in 15 years has made yen strong against the dollar since March and left it poised for further gains, as investors reassess carry trades. The yen came under heavy pressure as wide gap between borrowing costs in Japan and those elsewhere meant it was a popular choice as a funding currency for carry trades. These see investors borrow in a currency where interest rates are low - the yen has been popular - and then swap them for another currency in which they can invest in higher yielding assets (US dollar, AU dollar).

But with the BoJ raising rates at a time when cuts by central banks around the world are cutting rates. This shift could diminish the attractiveness of short yen positions, as the narrowing rate differential between the BoJ and other central banks, particularly the Fed which is expected to cut in September and December, makes the yen less appealing for carry trades. In 1998, there were two consecutive days of 10 (yen) 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. The same Yen strengthening cannot be ruled out today.

Japan Stocks plunged in a biggest two day fall in decade as Yen shows strength

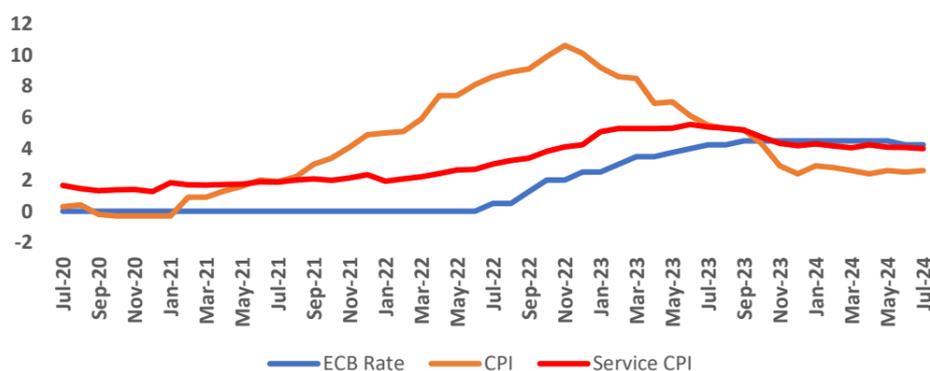
In a dramatic turnaround for Japanese equities touching record high in July. **The TOPIX fell 19% since the release of BoJ monetary policy.** The sharp reversal in Japanese stocks in recent weeks comes as the yen's rally to a four-month high against the dollar. Markets are deepening bets of US rate cuts because of concerns about slowing economic activity at a time when the Bank of Japan is only starting to tighten its policy settings.

JAPANESE YEN (¥ - JPY): View

An unambiguously hawkish stance from BoJ's Ueda shows that concerns over a weaker yen are now clearly aligned with the Ministry of Finance with both policies moving in the same direction for the currency. The USD/JPY is trading below 150 levels since March 24. The interest rate differential between the US and Japan is expected to narrow slowly with BoJ showing hawkish stance by two hikes this year, while Fed is expected to cut thrice this year. This will lead to unwinding of carry trades and ultimately strengthen the Yen.

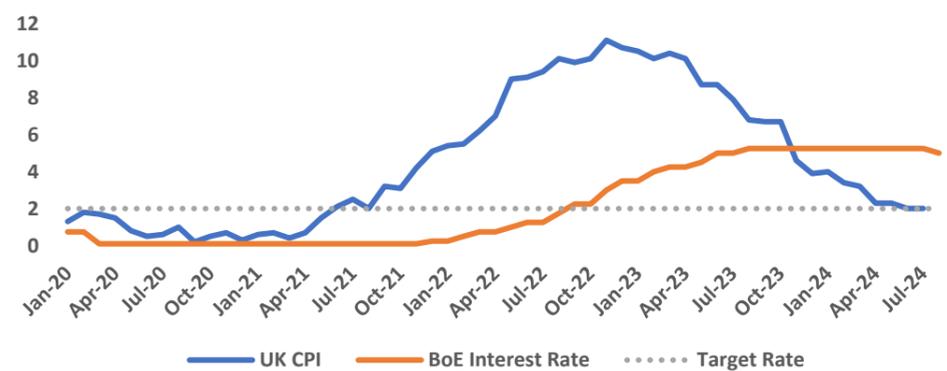
ECB maintained status quo in its policy as service inflation remains sticky (Fig 7)

ECB rate vs Headline CPI vs Service Inflation



UK Inflation stays at central bank level of 2% with BoE delivering its first rate cut (Fig 8)

UK CPI VS BoE Rates



Source: Bloomberg, UBI Research, CME Fedwatch Tool

Political stability and improving economic data will keep GBP at elevated levels

ECB continues its data dependency approach and keeps September rate move open

POUND (£ - GBP)

BoE cuts rate 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. The MPC warned, that the inflation is expected to go up to around 2.5% in the second half of the year due to the existing domestic pressures.

No verbal forward guidance

Forward guidance in the statement was quite limited. The MPC members again spoke of policy require to remain restrictive for sufficiently long. Bailey reiterated the point made by Lagarde and Powell, noting that while it pays close attention to services inflation, this does not mean that we should adjust our course with every data surprise that comes in. The MPC’s statement now merely says that it continues to monitor closely the risks of inflation persistence and will decide the appropriate degree of monetary policy restrictiveness at each meeting. Investors are fully pricing only one rate cut later this year.

Economic data remains mixed

The 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 three months to May.

Labour government to remain strict on Fiscal Front starts with spending cuts

Labour leader Keir Starmer achieved a historic win in July election. Starmer and his finance minister Rachel Reeves have also promised not to increasing borrowing for day-to-day spending, after identifying a £22 billion 'black hole' in spending plans for this year. Reeves announced 8.1 billion pounds of cuts for the next financial year and promised more measures during the budget. She made cuts to a range of projects such as roadbuilding and restoring railways, said she would review a scheme to rebuild hospitals and set an ambitious target for government departments to squeeze more than 3 billion pounds from their budgets. All eyes will be on the budget to be presented in October.

POUND (£ - GBP): View

Sterling is this year's top performing currency against the U.S. dollar. Even after rate cut by BoE the GBP is unlike to weaken significantly as rates remain high at 5%, while UK’s political, and macro data improves. The pair may again test the levels of 1.30. But as US Presidential approaches we may see safe heaven flows into US dollar which may weaken the pound. The pair is likely to trade in the range of 1.2650-1.3000.

EURO (€ - EUR)

ECB maintained status quo in its July monetary policy move, September is “wide open”.

In recently concluded monetary policy on 18th July ECB members unanimously kept it policy rates unchanged on expected lines. This decision was followed by June month’s landmark rate cut maintaining a restrictive interest rate framework for two years to tame inflationary pressure. 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

The latest inflation data show headline inflation at slight elevated levels

Yuan appreciated to six months high

strategy, continuously monitoring economic indicators, inflation trends, and the effectiveness of its monetary measures to make informed decisions about rate adjustments. 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 latest inflation report showed annual inflation slightly dropped to 2.5% in June, core inflation remained steady at 2.9%, and services inflation stayed elevated at 4.1%. Since the publication of June Uni-FX while the EUR had to process an unexpected election in France, where initial market concerns about political shifts were replaced by relief around results that point to policy continuity.

Inflation in the Eurozone accelerates.

The latest inflation report is one of two crucial monthly inflation readings that will inform ECB officials before the next ECB meeting on 12 Sep.

Preliminary figures showed that inflation in the Eurozone accelerated to 2.6% in July, from 2.5% in June. Core inflation, held at 2.9% for a third month, which was a tad higher than expectations of 2.8%.

EURO (€ - EUR) view:

The EUR/USD pair encountered strong selloff after the announcement of France Snap election but since then the EUR/USD pairs have showed strength and made high of 1.0948 on the backdrop of weak US dollar and hawkish ECB. Meanwhile the pair was unable to break strong resistance of 1.1000. Going forward in the near term, we expect the pair to remain strong as FED starts to cut its interest rates in September while ECB on wait and watch mode. In the short-term Euro may depreciate as US election take CenterStage and may provide flows in safe heaven currencies.

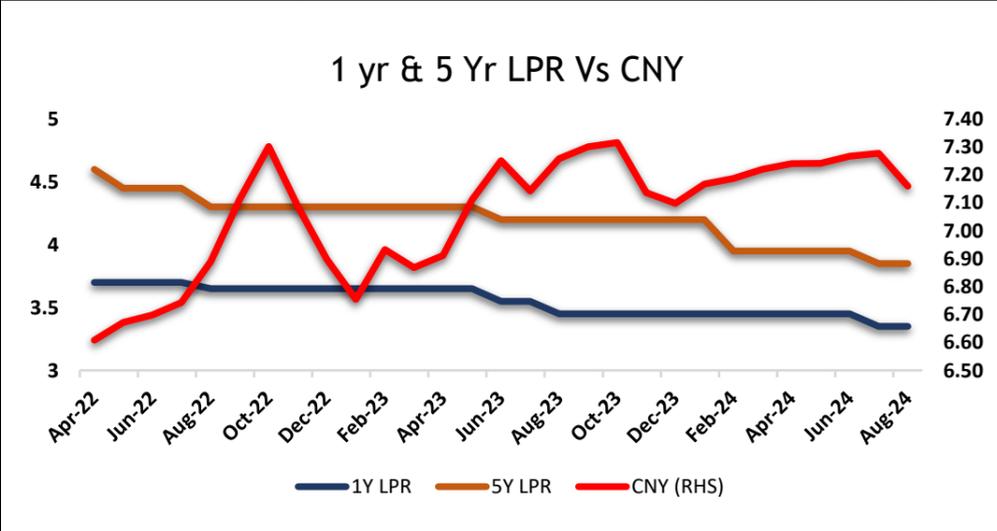
Chinese Yuan (¥)

Yuan boosts amid intervention fears and increased bets of FED rate cut

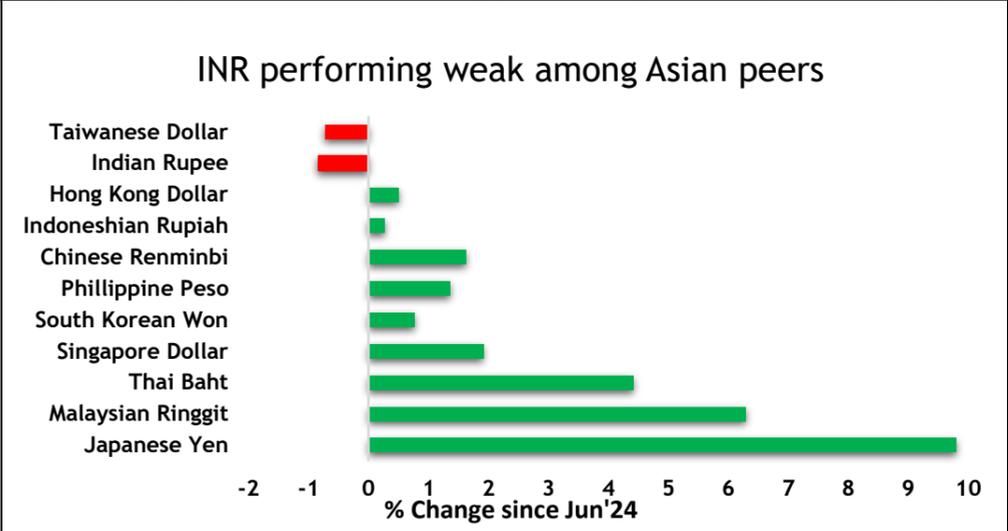
China's Yuan has recouped all its losses and headed for 6-month high (24th Jan'24 - 7.1405) against the dollar breaking which will open doors for levels last seen in Dec'23 (7.1083). This is likely to be widely supported by the fall in US yields after the US manufacturing data sparked fears of recession in US amid increased bets on a Fed rate cut in September. Meanwhile, China's July Caixin manufacturing PMI slid to 49.8 in July 2024 vis-a-vis 51.8 a month ago, marking the first decline since October'23. This concerning data was compounded by official figures, showing manufacturing activity decreased to 49.4 in July from 49.5 in June, the third consecutive month of contraction and the sharpest decline since February. The service sector also weakened, falls to 8-month low edging down to 50.2 in July vis-a-vis 50.5 in June, the slowest growth since November 2023.

However, the pressure on currency persists amid reports of higher import tariffs, trade restrictions with US, possible scrapping of Joe Biden's policies on renewable energy and electric vehicles (EVs). Also, according to experts, Trump, has also made his intent clear on what he plans to do in case he gets elected to the White House later this year. He intends to raise tariffs on China by 60-100% to an unspecified level. Washington was mulling tighter curbs on exports of advanced semiconductor

LPR rates cut in a surprise move while Yuan showing strength (Fig 9)



Rupee one of the weakest currency pair amongst Asian peers (Fig 10)



Source: Reuter, UBI research, Bloomberg

Plenum comes on expected lines nothing new for economy

Sudden rate cuts to support economy

Rupee remains insulated from global headwinds

technology to China. As per media reports, the US has told allies it is considering using the most severe trade curbs available if companies continue giving Beijing access to advanced semiconductor technology.

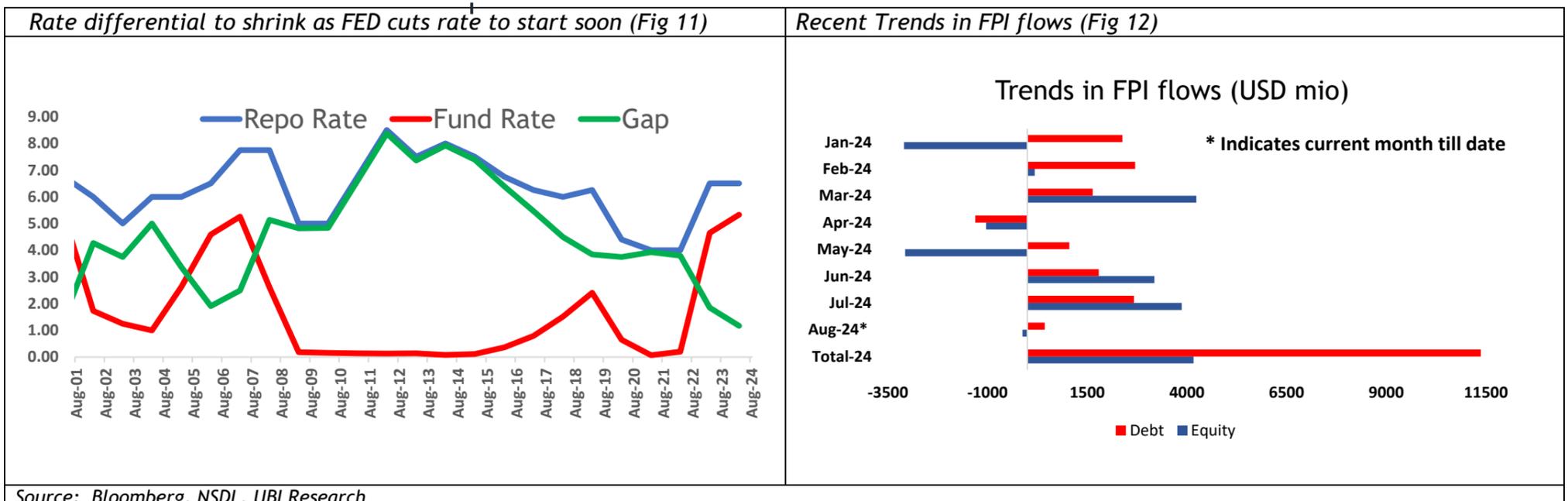
In Beijing, China's ruling party has concluded the all-important Third Plenum, a summit that takes place just twice a decade, happened on July 15-18 with its 20th Central Committee with a communique. The readout affirmed Beijing's commitment to balancing development with ensuring national security, and did not otherwise reveal policy changes. 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. There was little mention of anything that would directly address China's plunging real estate prices or the millions of unfinished apartments left behind by failed developers. These include forcing the private sector to retreat in order to help the state advance and tightening controls over foreign capital, which will hit the market economy hard.

The People's Bank of China (PBoC) has surprised markets by suddenly cutting the key lending rates to new record lows at the July fixing to help a lagging economy. The 1-year loan prime rate (LPR), the benchmark for most corporate and household loans, was slashed by 10bps from 3.45% to 3.35%. The 5-year rate, a reference for property mortgages, was also slashed by the same margin from 3.95% to 3.85%. On 22nd July'24, China's short-term interest rate, the seven-day reverse repo rate, was reduced to 1.7% from 1.8%, the first such cut in nearly a year, amid efforts to optimize open market operations and increase financial support. China's central bank on 25th July'24 cut a key interest rate, in Beijing's second move to try to offset the stock market's sharp fall across most of Asia in early trading, in an echo of Wall Street's sharp drop the day before. The 1-year Medium Term Lending Facility (MLF) interest rate (the other policy rate) to commercial banks was reduced by 20 bps to 2.3% from 2.5%. This is the biggest cut since a similar reduction in April 2020, when the Chinese economy was struggling because of a nearly national lockdown in the early days of the coronavirus pandemic. As per media reports, the seven-day rate could be the future benchmark policy rate as the PBoC recently signalled a shift toward the short-term rate to guide markets. This will reduce the importance of the existing 1-year benchmark, the medium-term lending facility rate.

INDIAN RUPEE (₹ - INR):

Rupee trading against tide, touched record low due to FPI outflows

July had been a highly volatile month where major global currencies witnessed huge rallies and tested multi month highs. However, most of them saw retracement amid profit booking and strength in Dollar due to robust US PMI data, while softer US PCE data & ISM manufacturing index fuelled rate cut hopes as recession fears resurfaced. The CME Fed-watch tool now shows 50bps rate cut fully priced in Sep'24. Markets are pricing in 4 rate cuts in total commencing Sep'24



Source: Bloomberg, NSDL, UBI Research

Higher tax rate on capital gains and securities transactions dampened FPI sentiment.

Cap on FAR route on government bonds amid inclusion in JP Morgan bond index

against the FED conservative expectations of 1-2 cuts. However, Rupee traded against the tide & traded in a narrow range throughout the month and hit fresh all-time lows where the upside was mainly capped by strong dollar sales amid intervention fears by the central bank. In the Union Budget, the government has revised the fiscal deficit target to 4.9% for FY24-25, down from the previous 5.1% in the interim budget, with an aim to reduce it below 4.5% of GDP by FY26, that is also anticipated to improve India's sovereign credit rating and economic standing, which in turn supported Rupee. The sentiment immediately reversed and INR touched its lowest level of 83.7275 (all time low: 83.76), pressured by the decline in local equities after the government's decision to raise the tax rate on capital gains and securities transactions (F&O) dampened market sentiment. Also, the weakening Chinese Yuan on the back of sudden rate cuts by PBoC to support its economy also dented the local currency.

RBI's recent announcement on Indian government bonds with a 14-year and 30-year tenor will no longer be accessible to Foreign Portfolio Investors (FPI) under the Fully Accessible Route (FAR) dented the sentiments further for FPIs and capped the inflows in debt as well. However, the existing 14-year and 30-year debt, which were already specified under the FAR will continue to be accessible. FPI flows witnessed a major change in the equity segment, till budget (23rd July) the inflow was \$4199.07mln which took a hit and outflows of -\$1191.03mn was seen after budget, while the debt has seen consistent inflows of \$2675mln in Jul'24 vis-à-vis \$1792mln a month ago.

RBI continued OMO sales for 3rd consecutive week with a total sale of Rs 3985cr in the week ended 26th July & cumulative of Rs. 10,125cr to absorb surplus liquidity amid FAR related inflows. The local currency kept elevated amid month end Dollar bids from importers was seen, due to oil and gold buying after import duty was reduced from 15% to 6% in the union budget. Rupee was capped from knee jerk depreciation using record high forex reserves \$667.39 billion kitty.

In the present scenario, RBI is not expected to lower rates soon (Refer our Report: [India - Conundrum between C-D Ratio and Real Rates](#)) and with expectations of softer US rates, USDINR hedging costs likely shoot up. Amid 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 84.00 mark. The central bank has taken appropriate measures to reduce the sudden volatility in the domestic currency.

However, the rise in interest rate differential lowest levels in 2000 is likely to open doors for 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.

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