The Summer of 2008 (Update)

• Slowing growth proved a key theme in the summer of 2008

• Weakening yield support in key yield-driven currency pairs was also apparent

• Transition from low to high-volatility environment proved rapid

Some of the similarities between the current situation in parts of the financial markets and that seen in the midsummer of 2008 (when a global slowdown was becoming increasingly apparent) were highlighted in yesterday’s *Aerial View*.

Given that August of that year saw significant trends develop in a number of key currency pairs, it’s worth pulling together a few of the key strands of the past day or so.

1. South Korea has just suffered its worst quarterly contraction since the financial crisis on a combination of slowing growth in China, the trade tensions between Beijing and Washington, a weakening technology sector globally and a 50% rise in oil prices since the start of the year.

The net result has been a sharp weakening of the KRW, taking it out of the narrow range that it has been in against the USD for the past 12 months.

It is therefore worth noting that a not dissimilar story

**Newswatch**

1. **China**: President Xi Jinping says that China won’t engage in currency depreciation that harms other countries. He adds that the CNY will be kept at a “reasonable, equilibrium level” and the market will play a bigger role in setting the exchange rate.
emerged in early August 2008 when, in the face of an active intervention campaign by the Bank of Korea, the USD broke upwards out of the narrow range it had been in against the KRW for several months. Over the next month the USD rose by around 14% while realized volatility tracked sharply higher.

The past 30 years have seen a number of examples of how narrow the exit door can prove for these currency pairs

2. If South Korea is a perfect example of the slowing global growth story then it also makes sense that bellwethers such as AUD/JPY and CAD/JPY - that have already been undermined by weakening yield support - should be coming under increasing pressure.

Given that the past 30 years have seen a number of examples of how narrow the exit door can prove for these currency pairs, it’s worth recalling how events played out in August 2008.

At that point, the combination of slowing global growth and weakening yield support, coming at the end of an extended period of low volatility, proved potent. From early August to early September, the AUD dropped about 15% against the JPY while the CAD fell about 8% and realized volatility in both pairs tracked higher.

2. **China**: Bloomberg notes that the People’s Bank of China set its daily reference rate today “at a level which was stronger than all forecasts that 17 traders and analysts gave Bloomberg.”

3. **Japan/US**: Finance Minister Taro Aso says he told Treasury Secretary Steven Mnuchin that Tokyo cannot accept discussions that link monetary policy to trade issues. He also says that they have agreed that exchange-rate matters would be discussed between financial authorities, and that Tokyo and Washington should not talk about currency issues in the context of the trade debate.

4. **Japan**: Industrial production falls 0.9% m/m in March (Reuters consensus forecast -0.1% m/m; previous 0.7% m/m)
This is an echo of summer 2008 when weak PMI and Ifo had been highlighting the contraction in the region’s manufacturing and services for a number of months.

3. Europe remains closely connected to the slowing growth story given the recent run of data out of Germany. This is also an echo of the situation in summer 2008 when weak PMI and the Institute for Economic Research had been highlighting the contraction in the region’s manufacturing and services for a number of months.

Back then, it had taken until early August for the EUR to finally break out of the narrow range it had found itself in for the previous four months.

However, when the move came it proved substantial, with the EUR falling about 9% against the USD over the next month while realized volatility headed sharply higher. Given this, it was therefore interesting to see the EUR finally breaking down out of its range on Wednesday of this week.
As noted before, history, of course, does not repeat itself. However, given the transition from a low to a high-volatility environment seen back in 2008, this seems a useful example to keep in mind in light of the price activity seen this week.

Please direct questions or comments to:

AerialView@BNYMellon.com

Disclaimer