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The Aerial View

Morning Briefing

Living With the New Normal

- **Sustained USD weakness would see many central banks put normalization plans on ice**
- **There is no appetite to modify central bank mandates**
- **We might expect to hear the sort of jawboning to which we have become accustomed**

Friday's non-farm payroll report poses the first test for USD bears in 2018. If they remain in control, various forecasting units will not be alone in modifying their projections for the year: many central banks may have little choice but to place their existing plans for policy normalization on ice.

As we see it, "currency wars" – a term popularized by Brazilian Finance Minister Guido Mantega in 2010 – has constituted a prolonged period of attrition among central banks vying for competitive advantage in order to meet similar objectives.

As vulnerable growth and mandate-testing low inflation prevails across much of the G20 in 2018, a sustained weakening in the USD could not be considered a benign event: it has the potential to derail projections and plans.

> ***A sustained weakening in the USD could not be considered a benign event***

Neil Mellor
Senior Currency Strategist,
BNY Mellon

Email >

Newswatch

1.
China announces new crack down on leverage >

2.
FOMC minutes affirm focus on three hikes for 2018 >

3.

The notion that global low inflation is the product of temporary factors – energy, tax shifts and so on – has long since given way to endless discussions about the “new normal” or the new, lower interest rate that is consistent with trend growth in an economy where labor market constraints have failed to impact wage growth and where inflation expectations have collapsed.

Many G30 officials have therefore questioned whether the ‘end’, or appreciable levels of inflation, can justify the ‘means’ of distortive levels of interest rates. But in a post-crisis world nursing high levels of debt and a diminished toolkit with which to fight any renewed downturn, there is no appetite to modify central bank mandates in order to accommodate this new ‘paradigm’.

The result has been a cautious status quo on monetary policies across the globe for central banks facing a much diminished margin of safety with respect to their forecast for growth and inflation. And so it is that, time and time again in the past few years, we have seen many central banks take tentative steps on the road towards policy normalization only to face the stark reality of reluctant inflation and/or untoward currency appreciation.

> ***None of these Banks preside over inflation rates that could easily absorb a sustained appreciation of currency***

In this group of banks we would include Norges Bank, Riksbank, the RBNZ, RBA, BOE, ECB and most recently the BOC, with the approach to market communication varying from the subtle and reticent (BOC) to the blunt and forthright (RBNZ).

Although they're all at varying stages of the policy normalization process, not one of these banks preside over core inflation rates that could easily absorb a sustained appreciation of currency.

Hence, were USD bears to prevail, then we might expect to hear the sort of jawboning to which we have become accustomed. In fact, firefighting against a weaker USD has already begun in 2018: yesterday, three people ‘familiar with the matter’ informed Reuters that the South Korean

Caixin PMI puts China services activity at three year high >

4.

BOK Governor warns against "herd" behavior >

5.

UK house price inflation ticks up - Nationwide >

On the Radar

January 04, 2018

• EZ Dec composite PMI (f) (0900 GMT)

• US Dec ADP employment (1300 GMT)

• James Bullard (1830 GMT)

Featured Article

Risk and the JPY Crosses

Positive sentiment should continue to support the JPY crosses in early 2018 >

government is to consider measures to boost capital outflows if the KRW continues to rise sharply. And South Korea is far from being alone in this particular boat – indeed, it has become fairly crowded.

Please direct questions or comments to:

AerialView@BNYMellon.com

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bnymellon.com