Currency Wars and the USD

- An equally evocative issue has emerged post-G20
- Refusal of bonds to cede gains a troubling sight
- The USD may seem striking next to some currencies

While markets were transfixed by the Trump-Xi tête-à-tête, and inspired by its conclusion, an equally evocative issue has emerged in its wake: the woeful health of the global manufacturing sector.

As this can only accentuate the pressure on central banks to conjure remedial measures, the tacit desire to avoid uncompetitive movements in currency can only grow.

The refusal of bonds to cede even a modicum of their stellar year-to-date gains may be a boon to stocks but it is a troubling sight for central banks with their feet flat to the floor on the monetary throttle.

Little wonder though: the gamut of PMI data from Sunday onwards – from China to the eurozone via the UK and Russia – largely pointed to contraction with, generally speaking, little in the way of detail from the sub-indices to suggest better news is on the way.

Meanwhile the Tankan hit a 3 year low; the BCC from the UK hit a 7 year trough; and the first sub-50 figure for the Spanish PMI in six years is certainly noteworthy in view of the country’s recent ability to stay clear of the mire.

Newswatch

1. The US government has released a list of additional EU products that could be hit with tariffs

2. President Trump tells reporters that a China trade deal has to be "somewhat tilted to our advantage"
We argued on June 17 that gold’s traction may reflect a collapse in faith in currencies generally and in view of what are likely to be seen as requisite policy settings, confidence is hardly about to revive.

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The RBA today cut rates for the second consecutive month and made clear that further easing cannot be discounted. Tomorrow we shall see if Riksbank postpones a hike into 2020 as some expect.

As for China, we suggested on Thursday that any cessation in trade hostilities might still leave the year’s growth target in some jeopardy – a question left open by the June PMI data – and by extension, the issue of accommodating currency moves could be revisited.

This remains feasible: on Monday morning, the PBOC announced that it “will play an active role in responding to China-US trade frictions” but also “prevent external shocks” – the latter being very much in keeping with recent comments from PBOC Governor Yi Gang extolling the virtues of greater flexibility in the CNY.

Since the ink dried on the Osaka communique we have also heard from no fewer than four ECB officials speaking as one. That ‘inflation is far from target’, said Hernandez de Cos, obviously means “we’re in a difficult situation”.

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Philip Lane noted that the ECB should pay attention to

3. RBA cuts rates and leaves door open for more >

4. China to end foreign ownership limits by 2020 says Li >

5. German retail sales slide in May contrary to expectations >

On the Radar

July 02, 2019

• UK Jun construction PMI (0930 GMT+1)

• Mark Carney (1505 GMT+1)

• CA Jun manufacturing PMI (1430 GMT+1)

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China Update

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market based inflation expectations (the 5yr / 5yr breakeven rate has lost half its Draghi-bounce); Klaas Knot, having just noted that inflation is too low, said that the ECB would act in “adverse scenarios”. Olli Rehn said the ECB stands ready to adjust all of its instruments.

And although there is some uncertainty about the ECB’s true intent given the end of Draghi’s tenure in three months’ time, it should be said that one noted opponent of ECB largesse appears to have had something of a Damascene moment.

The point in all of this is that the weaker USD scenario has been largely predicated on a view of Fed policy seen largely in isolation. But the number of central banks that find themselves presiding over their own ‘ugly’ currency suggests that the USD may appear positively striking to some in comparison.

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