Currency Wars and the Press Gang

- The race to the bottom on rates continues
- Those central banks holding-out risk the offside trap
- The fate of EUR bears lies with the FOMC

Engaging in "currency wars" is hardly something central banks are likely to acknowledge. But either way, a growing number of policymakers are being obliged to sharpen their rhetoric.

Prevalent talk of a weaker USD at the start of the month was largely predicated on a view of Fed policy seen largely in isolation.

We argued that the number of central banks presiding over their own "ugly" currency meant that the USD could well appear positively striking to some in comparison.

We mention this because the USD Index has since risen 1.5% amid clear evidence that the world’s major central banks are increasingly resigned to joining a race to the bottom on rates.

At the vanguard of this race is the RBA. The AUD slid mid-week after one bank slashed its own projections for Aussie rates. But far from disabusing the bank in question, RBA Governor Philip Lowe subsequently noted that it was entirely “reasonable” to expect an extended period of low interest rates.

Newswatch

1. Downing St sources say UK PM Johnson adamant on Irish backstop issue despite Juncker rebuff

2. Japanese government preparing to remove South Korea from favoured trading list as early as next week
In making this comment, Mr Lowe denied he had modified forward guidance, but then, the use of apophasis – intentional or otherwise – is a familiar one.

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Policymakers are capable of making passive observations without genuine intent, but what difference does this make? The market, where prices reflect all known information and risks, cannot simply discard the knowledge that officials are fully aware of the impact that their remarks can have.

And the RBA is far from being alone in looking to assure on its commitment to easy money.

As just one example, Bloomberg reported mid-week that “the [RBNZ] has begun scoping a project to refresh our unconventional monetary policy strategy and implementation. This is at a very early stage.”

But the point in noting all of this is that two of its implications immediately come to mind.

Firstly, it underpins the bullish case for gold – something we discussed again this week. And secondly, it risks those central banks holding-out against further easing falling into an offside trap entailing untoward currency strength.

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With the BOJ board meeting early next week, sources confirm that it remains split on the merits of further easing,
despite perennial problems exacerbated by trade pressures; but one of the prime incentives of those looking to ease again is the specific risk of the JPY being squeezed higher as the BOJ stands pat. Perhaps unsurprisingly, a recent Reuters poll suggests, overwhelmingly, that those holding out will relent.

Meanwhile, although the Bank of Canada sees a high bar to any cut, it is troubled by the trade outlook and its concerns cannot exist independently of the very mechanism - the CAD - through which pain is amplified.

With iFlow data pointing to consistently strong buying of the currency, we suggested this week that any breach of USD/CAD 1.30 could well entice the BoC into one of its periodically abrupt shifts in view.

This brings us to the ECB. We suggested at the start of the month that if the ECB were seen to fall short of the air of urgency that seemed so apparent at Sintra just under a month ago, USD bears might just find a suitable vehicle with which to express their views in the EUR.

In view of the seemingly indifferent reaction to Mr Draghi’s overtures yesterday, EUR bears' hopes would therefore appear to lie solely with a rather less dovish FOMC than many expect.

**NB Please note that the next Morning Briefing will be published in the week of August 12th**

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