SMBC Capital Markets, Inc.

fxPoetry

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Fool's Paradise

While Christine would have you believe
That she and her clan can achieve
A landing quite gentle
Through more governmental
Intrusions, that seems quite naïve

Thus, markets are starting to price
An outcome that's not very nice
The euro is tumbling
While stocks keep on crumbling
Amid Christine's fool's paradise

The first thing one notes this morning when scanning markets is the euro's decline. While we have seen other currencies move sharply every so often (actually more frequently than that) I think much solace has been taken in the fact that the single currency has remained fairly well behaved overall. While it has traded lower over the past 18 months, it has been a pretty gradual decline without too many single day surprises. And, of course, there has been much discussion as to the idea the euro was heading to parity based on the dramatic difference in the relative monetary policy stances of the Fed and ECB, although the timing of said move remained highly uncertain. Perhaps, this morning, that timing is coming into clearer view.

We all know the Fed remains uber hawkish despite the fact that recent data is pointing to a significant slowing in the US economy. However, the European story is a bit different as despite rampant inflation (CPI of 8.6%), the ECB needs to worry about 'fragmentation', their latest euphemism for the collapse of the Eurozone amid economic crises in the PIGS.

We have already discussed how the latest wheeze is simply QE repackaged with the ECB now explaining it would take the proceeds of maturing Bunds, OATs and Dutch government bonds and use those to buy BTPs, GGBs, Bonos and PGBs in order to prevent the yields on the latter group from rising too far above those of German bunds. Well, it seems that as investors observe the ongoing buffoonery by the ECB, they are losing some of their sanguinity over the euro's nearterm future. It seems that the inherent contradictions in comments like," [we] need to continue to normalize ECB monetary policy" and "fighting fragmentation shouldn't interfere with [the ECB's] stance" as spoken by Vice President Luis de Guindos this morning are becoming a concern.

Though the ECB seems quite likely to raise their deposit rate by 25 basis points in two weeks' time, that is weak sauce given the inflation situation. And that inflation situation does not even include the potential for dramatically higher energy prices as winter approaches should Russian President Putin decide to turn off the gas to Europe. While there is much talk about rising energy prices, that will take things to an entirely new level, one that will have extraordinary ramifications for the continent as entire industries may be shuttered with economic activity going into reverse, yet price pressures will remain extreme in energy, and therefore in everything else.

When considering these issues, it is quite easy to understand the euro's renewed weakness. And in truth, there is nothing to prevent the euro from declining much further. While there has been much focus on parity, recall, the historic low for the euro is 0.8230 back in October 2000. Though I don't believe the euro will fall that low (I think the Fed half of the story is likely to change far before we reach that level with much slower growth forcing the Fed to rethink their policy tightening) at this time, there is nothing from Europe that seems bullish in any fashion. I agree parity is on the cards and don't see any reason we can't trade as low as 0.90-0.95 before things change.
Given the combination of stories we see this morning alongside the probable policy responses, it should be no surprise that risk is under. While equity markets in Asia were mixed (Nikkei +1.0%, Hang Seng +0.1%, Shanghai 0.0%) Europe is under much more pressure (DAX -0.9%, CAC -1.0%, FTSE 100 -0.8%) after Services PMI data did nothing to dissuade the bears about their views. (This is in contrast to China's Caixin Services print which was much higher than forecast at 54.5.) US futures at this hour are also pointing lower, somewhere around -0.5% across the major indices.

Meanwhile, bonds, which had an extraordinary session on Friday before the holiday, with 10-year yields tumbling 13bps and the entire curve slumping as well, are edging a bit lower this morning with yields up 2.6bps. However, European bonds, which saw similar price action to the US on Friday, reversed all of those price gains yesterday and started this morning basically where they finished Thursday. So, given the risk off sentiment in Europe, it is not that surprising to see yields edge lower there (Bunds -2.6bps, OATs -0.7bps, Gilts -4.1bps) although BTPs (+1.4bps) are bucking the trend as fears over exactly what the ECB is going to be able to do remain rampant.

Oil prices this morning are under a bit of pressure with WTI (-0.25%) and Brent (-1.5%) feeling the repercussions of all the recession talk. NatGas (-3.0% in US +4.1% in Europe) continues to show a remarkable bifurcation although one has to believe that gap will close over time. Aluminum (-2.8%) is the underperformer in the metals space with copper unchanged and gold (-0.4%) barely hanging on to $1800. However, given the dollar's broad-based rise, it is not that surprising that gold remains under pressure.

Speaking of the dollar, it is the universal winner today. In the G10, aside from the euro (-1.2%) we see SEK (-1.2%) and NOK (-1.1%) at the bottom of the queue with AUD (-1.0%) and NZD (-0.85%) not far behind. There are no stories beyond broad dollar strength here, as the RBA's rate hike of 0.50% was widely anticipated and had no impact of note. In fact, the best performer in the G10 is JPY (-0.25%), which says it all.

The author is a salesperson in SMBC Capital Markets, Inc.
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The story is no different in the EMG bloc where every single currency is weaker vs. the dollar except for those which have not yet opened in LATAM. HUF (-2.0%) and PLN (-1.7%) lead the way lower as both exhibit their high betas to the euro, with the rest of the EEMEA bloc all under significant pressure. MXN (-0.45%) by comparison looks good and the APAC currencies mostly had declines on the order of -0.2%, thus nothing special there. This is a dollar story, full stop.

It is an important data week with the FOMC Minutes and payrolls coming:

Today	Factory Orders	0.5%
Wednesday	ISM Services	54.0
	JOLTS Job Openings	11.0M
	FOMC Minutes	
Thursday	Initial Claims	230K
	Continuing Claims	1330K
	ADP Employment	200K
	Trade Balance	-$84.9B
Friday	Nonfarm Payrolls	273K
	Private Payrolls	240K
	Manufacturing Payrolls	25K
	Unemployment Rate	3.6%
	Average Hourly Earnings	0.3% (5.0% Y/Y)
	Average Weekly Hours	34.6
	Participation Rate	62.4%
	Consumer Credit	$30.0B

Source: Bloomberg

The funny thing about the FOMC Minutes is I believe they have lost much of their previous caché as FOMC members never shut up between meetings and bare all to us on a daily basis. As such, reading about what they thought three weeks ago, absent all the new data, seems unlikely to offer much insight. Payrolls, however, given the ultra-high profile of the employment situation, are likely to be far more important. While still reasonably strong, that number has been trending lower pretty consistently for the past 15 months as Covid recedes into the background and growth appears to be slowing. In addition, the Consumer Credit number has grown in importance as an indicator of how people are coping with rising prices. We have seen the two largest jumps in history at the beginning of the year, so it appears that many folks are borrowing to pay their everyday expenses. That is a situation that cannot last for too long, another negative for the economy.

For now, I would not stand in front of the train that is the US dollar. But I fear that the recession here will become more evident over the coming weeks and that the assumed change in policy by the Fed will be enough to slow the dollar's ascent. Of course, much depends on what the other side does as well.

Good luck and stay safe
Adf

PS, for those who made it this far and would be interested in hearing the podcast I mentioned on Friday, here is the link:

https://anchor.fm/marketchampions/episodes/212Trading-At-a-Bank-in-the-1980s-ft--Andy-Fately-with-Srivatsan-Prakash-e1kp8u8

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