Fixed Income Weekly

FOR PROFESSIONAL INVESTORS

Logan

July 31, 2017

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Key takeaways

- The once invincible US Dollar is starting to look fragile
- Inflation to be the dominant driver in the third quarter
- It might not be over for the Greenback just yet

Full commentary

In the tenth installment in the X-Men film series, an aged Wolverine, Logan, undertakes a final adventure in a dystopian future. His healing factor has faltered and, as a result, his body has aged and can no longer heal at the same rate as before. Similarly, the once invincible U.S. Dollar is starting to look fragile.

After rallying 30% between mid-July 2014 and December 2016, the US Dollar retraced a third of its appreciation this year and it is the weakest currency in G10 year-to-date. Is this trend going to continue into the end of the year? It is pretty clear that foreign central banks have moved away from specifically targeting currency weakness and are more open to allowing their currency to appreciate. Devaluing the currency doesn't work when everyone is doing it. Even the Swiss National Bank (SNB) was forced to accept a stronger Swiss franc and abandon the floor of 1.20 against the euro. This change from explicitly keeping their currencies weak to allowing some appreciation is significant as competitive currency devaluation was the main driver for the first leg in the US dollar rally.

The table may have turned now, with foreign central banks sounding more hawkish while the Federal Reserve had to acknowledge lower than expected inflation in the US. However, simply extrapolating the currency moves year-to-date and looking for further US dollar weakness might be too dangerous. An aged Logan managed a strong comeback at the end of the movie. We would be surprised if the same happens in the foreign exchange market. Some higher than expected inflation numbers in the US might easily trigger a strong comeback for the Greenback. Inflation will remain the most dominant driver in the foreign exchange markets in the coming months. The US dollar is already overvalued and one of the key reasons for its rally is no longer valid as foreign central banks are open to allow their currencies to appreciate. However, higher interests rates in the US will continue to support the US dollar until foreign central banks start normalizing more aggressively.

This week's market developments

Monday, July 24

- Markit Eurozone Manufacturing PMI growth (prelim estimate) decreased to 56.8 for July
- Market Eurozone Services PMI growth (prelim estimate) remained at 55.4 for July
- Markit US Manufacturing PMI growth (prelim estimate) increased to 53.2 for July
- Markit US Services PMI growth (prelim estimate) remained at 54.2 for July
- US existing home sales decreased to 5,520,000 for June

Tuesday, July 25

- US Conference Board Consumer Confidence Index increased to 121.1 for July

Wednesday, July 26

- UK 2nd quarter GDP growth (advance estimate) increased to 0.3% q.o.q.
- US new home sales remained at 610,000 for June

Thursday, July 27

- US durable goods orders growth (prelim estimate) increased to 6.5% m.o.m. for June
- US wholesale inventories growth (prelim estimate) increased to 0.6% m.o.m. for June
- Japan National CPI growth remained at 0.4% m.om. for June

Friday, July 28

- US 2nd quarter GDP growth (advance estimate) increased to 2.6% q.o.q.

Source: Bloomberg, as of July 31, 2017

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Chart of the Week

US Dollar Weakened

Source: Bloomberg; data as of July 31, 2017

Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on September 2017 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	June 14, 2017	1.00% - 1.25%	1.15%	September 20
ECB	-5 basis points	March 10, 2016	0.00%	-0.18%	September 7
BoJ	-20 basis points	February 16, 2016	-0.10% - 0.00%	0.07%	September 21
BoE	-25 basis points	August 4, 2016	0.25%	0.32%	August 3

Source: Bloomberg, July 31, 2017

Next week's market developments

Monday, July 31

- No material developments to note

Tuesday, August 1

- Markit Eurozone Manufacturing PMI growth (final estimate) is expected to remain at 56.8 for July
- Eurozone 2nd quarter GDP growth (advance estimate) is expected to remain at 0.6% q.o.q.
- US personal income is expected to remain at 0.4% for June
- US ISM Manufacturing Index is expected to decrease to 56.5 for July
- US construction spending is expected to increase to 0.4% m.o.m. for June

Wednesday, August 2

- US ADP National Employment Report is expected to increase to 190,000 s.a. for July
- UK Markit/CIPS Construction PMI is expected to decrease to 54.0 s.a. for July

Thursday, August 3

- US factory orders growth is expected to increase to 3.0% m.o.m. for June
- US durable goods orders growth (final estimate) is expected to decrease to 0.0% m.o.m. for June

Friday, August 4

- Germany factory orders growth is expected to decrease to 0.5% m.o.m. for June
- US change in non-farm payrolls is expected to decrease to 180,000 m.o.m. for July
- US unemployment rate is expected to decrease to 4.3% s.a. for July

Source: Bloomberg, as of July 31, 2017