COMMERZBANK

FX Research

Daily Currency Briefing

Fed about to cut rates in September, will the BoE do so today?

1 August 2024

Michael Pfister
Tatha Ghose

Table of contents

All options left open, but everything points to imminent rate cuts // JPY: A follow-up to yesterday's BoJ decision // GBP: BoE decision is set to be exciting // CZK: 25bp rate cut unanimously expected today

All options left open, but everything points to imminent rate cuts

As expected, the Fed left interest rates unchanged yesterday - but at the same time provided a few hints in its **statement** that a rate cut is imminent. Inflation is now only 'somewhat elevated' rather than 'elevated'. And the FOMC is now wary of the two-sided risks to its dual mandate. Nevertheless, policymakers still want to gain greater confidence that inflation will return to the 2% target. The statement was therefore only a small step towards a turnaround in interest rates; the market was probably hoping for clearer signals and the USD initially benefited from the statement.

This did not last long, however. During the subsequent press conference with Fed Chairman Jerome Powell, it became increasingly clear that the FOMC was on the verge of cutting rates for the first time. Although Powell initially tried to keep all options open for September, the hints became clearer as the meeting progressed. Initially, it was said that a September cut was possible if inflation continued to fall as expected. However, Powell later revealed that FOMC members had already discussed a rate cut yesterday. In addition, he now saw a higher quality in the disinflation process, with price pressures on services also easing in the meantime. Admittedly, Powell was also very much on the defensive, with almost every question focusing on whether the Fed was already behind the curve, i.e. had already missed the right time for the first rate cut. The USD suffered somewhat as a result.

I think Powell has made it quite clear that the first rate cut will come in September - barring unforeseen circumstances, of course. And there will probably be one more this year. But he also made it quite clear that there is nothing more to be expected for the time being. For Powell, an outright 50bp cut in September was out of the question. He also sounded quite cautious in other respects, reiterating that the economy is now in balance. Therefore, I would not push rate cut expectations - and thus USD weakness - much further in the absence of new data.

Perhaps one final note: Powell has shifted the focus in many of his comments to the labour market. Inflation is no longer seen as the main problem, but the dual mandate really is one again. This is a continuation of what we have seen in recent weeks and increases the importance of tomorrow's US payrolls report.

Author: Michael Pfister

JPY: A follow-up to yesterday's BoJ decision

To be honest, I did not expect such a hawkish surprise from the Bank of Japan (BoJ) yesterday morning. In addition to the actual rate hike, it was even made clear that further rate hikes could follow if the BoJ's new forecasts materialise. Most economists were probably surprised as well, with the majority expecting a later hike. And the new forecasts have made it clear why this is the case. But first things first.

The BoJ now **expects** a slightly lower inflation rate this year (2.5% instead of 2.8% y/y), but the forecast for next year has been revised slightly upwards (to 2.1% instead of 1.9% y/y). For the core rate, officials continue to expect a rate of 1.9% this year and next, and, somewhat surprisingly, the rate is even expected to rise again in 2026. This is despite the BoJ's recent rate hikes and the fact that it has hinted at more to come. This seems to imply that inflationary pressures are too high; the BoJ is probably worried that second-round effects will push up inflation too much.

Regular readers of our Daily Currency Briefing will know that we have our doubts about this view. Basically, the officials are assuming that inflationary pressure on the core rate will pick up in the coming months. In order to achieve this forecast, rates would have to be roughly in line with the inflation target for the next 9 months (see chart below). This is not impossible; other central banks have made more unrealistic forecasts in the past. However, it would be well above the average of the 2010s, and given the easing of global inflationary pressures and the recent appreciation of the yen, a lot would have to go right for this to happen.

On the other hand, although the BoJ expects slightly weaker growth this fiscal year, this will not affect growth next fiscal year. Again, despite the rate hikes this year. And despite the fact that the BoJ has more rate hikes in mind and that growth has been very weak recently. It is possible that the BoJ is assuming that it will no longer have to suffocate the real economy in order to get inflation under control. Nevertheless, the forecast seems rather optimistic, especially considering that the forecasts for 2025 and 2026 are above the average of the 2010s.

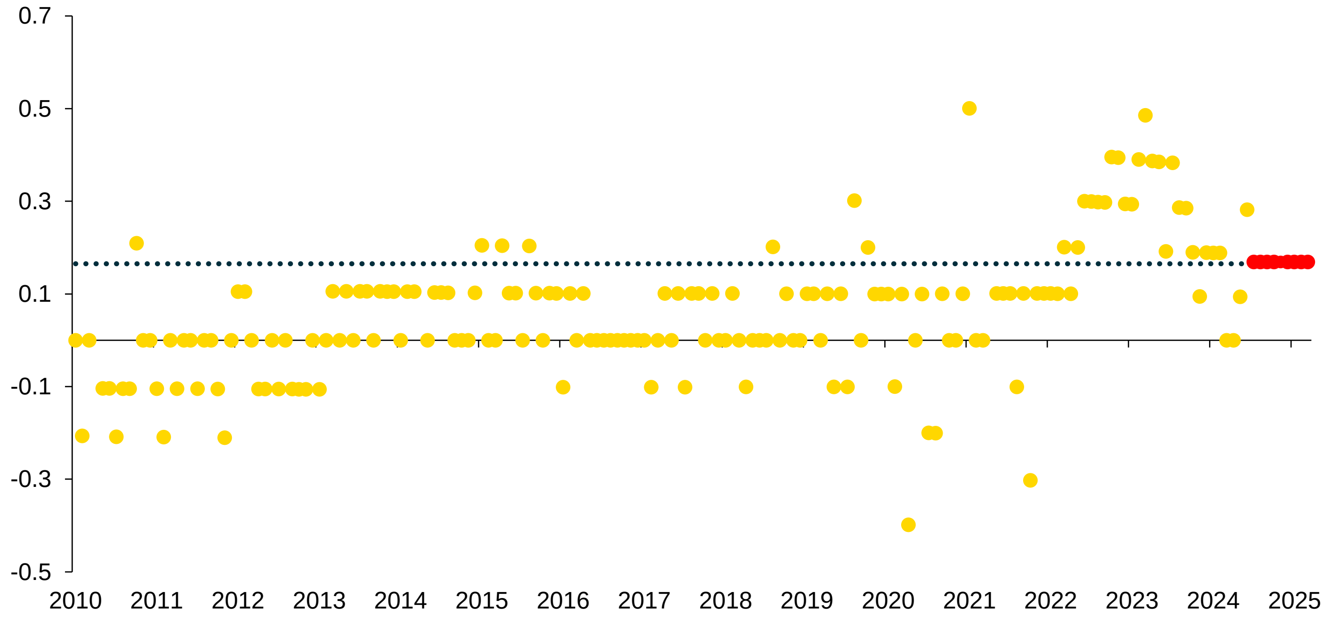
One gets the impression that the BoJ does not expect its more hawkish stance to have any impact. Neither on inflation (where there are many reasons for lower rates) nor on growth. From this perspective, its hint of further rate hikes is only consistent. In the short term, with such a reaction function, there should be little to argue against the yen - especially if the Japanese Ministry of Finance also takes advantage of appropriate moments to intervene. Yesterday morning's move after the press conference at least looked very much as if someone had helped.

In the longer term, however, I would not be so sure. If inflationary pressures do not pick up as expected and the real economy surprises on the upside, the BoJ's narrative is likely to be difficult to sustain. But that is more of a problem for the future.

Author: Michael Pfister

Figure 1 - Inflation must pick up again somewhat

Japanese inflation excluding fresh food and energy, seasonally adjusted month-on-month values, including rate to be reconciled with the 2% target, values marked in red required to achieve the forecast for fiscal year 2024



Source: Economic and Social Research Institute Japan, Bloomberg, Commerzbank Research

GBP: BoE decision is set to be exciting

The Bank of England (BoE) will conclude this week of exciting G10 central bank decisions around noon today (see above). The market is now leaning slightly more towards a first rate cut, with the vast majority of economists surveyed by Bloomberg expecting one. We also expect the BoE to begin cutting interest rates today.

Fundamentally, it makes little difference to the pound whether the BoE cuts rates today or waits until September. We have often pointed out here that 25 basis points less carry should make little difference over such a short period of time. However, the fact that the headline rate has recently fallen to the inflation target and that the BoE gave the impression of an imminent cut back in May - which was only postponed due to the election - argues in favour of a first cut already today. In addition, new forecasts will be released today, giving the BoE a bit more justification for its decision.

In addition to the actual wording of the decision, the medium-term forecasts are also likely to be important for the pound. If the BoE stresses that core inflation remains stubbornly high and that only small rate cuts are warranted in the coming months, this is likely to be positive for the pound. On the other hand, it would be a different story if the BoE were to emphasise the possibility of further rate cuts. However, this is not our base-case scenario, given the recent hawkish comments from officials.

Author: Michael Pfister

CZK: 25bp rate cut unanimously expected today

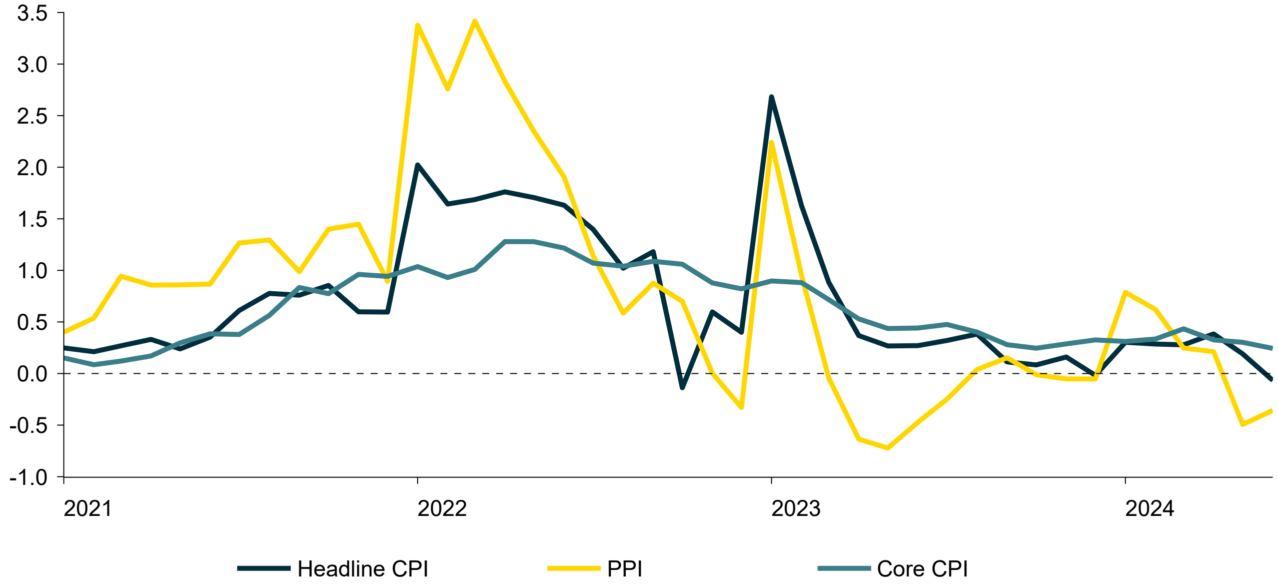
The Czech National Bank (CNB) surprised the market with a larger-than-expected rate cut in June, but tried to calm down negative sentiment by highlighting pro-inflationary risks in its accompanying statement, and stating that the board might pause rate cuts in August. Later at the press briefing, however, governor Ales Michl's remarks appeared contradictory, and not specifically hawkish, after which EUR-CZK began to drift progressively higher in following weeks. This CZK depreciation was amplified because CPI and PPI data (for June) also confirmed pronounced disinflation (deflation in month-on-month terms, see figure below). Since that data publication, expectations have become unanimous that CNB will lower the rate once more at the August meeting, but only by 25bp.

In our view, dovish CPI/PPI data have no fundamental reason to weaken the koruna. Quite the contrary. The data only support CNB's surprise 50bp rate cut of June, and argue that regardless of whether CNB will lower rates by 25bp for the last time, or cut rates further in coming months, inflation developments are likely to outrun such rate cuts – in other words, the real interest rate will continue to rise. This is positive for the koruna. Nevertheless for now, the FX market has locked-in a reflex reaction to sell the currency when dovish developments occur – this can well continue for the near-term.

Author: Tatha Ghose

Figure 2 - Pronounced disinflation in the Czech Republic

Headline and core HICP, PPI, m/m (seasonally-adjusted, exponentially-smoothed) in %



Source: Stats Office, Eurostat, Commerzbank Research

Data calendar

	Time	Region	Release	Unit	Period	Survey	Prior
01 August	07:00	GBP	Nationwide House Price Index	mom	JUL	0.1	0.2
				yoy	JUL	1.8	1.5
	07:30	SEK	Swedbank PMI Survey		JUL	54.0	53.6
	08:55	GER	PMI (Markit)		JUL F	42.6	42.6
	09:00	EUR	PMI (Markit)		JUL F	45.6	45.6
	09:00	NOK	Puchasing Manager Index		JUL	-	47.7
	09:30	GBP	PMI (Markit)		JUL F	51.8	51.8
	10:00	ZAR	Investec PMI		JUL	48.0	45.7
	-	ZAR	Vehicle sales	yoy	JUL	-9.4	-14.0
	12:00	GBP	Interest rate decision	%	AUG 1	5.00	5.25
	13:30	CZK	CNB interest rate decision	%	AUG 1	4.50	4.75
	13:30	USA	Initial jobless claims	K	JUL 27	236	235
	14:00	RUB	FX and gold reserves	USD bn	JUL 26	-	611.3
	15:00	USA	ISM manufacturing		JUL	48.8	48.5
			prices paid		JUL	51.8	52.1

Source: Bloomberg

Forecasts

Commerzbank FX forecasts

Strategic Currency Briefings

Analysts

Michael Pfister
FX Analyst
+49 69 935345614
michael.pfister@commerzbank.com

Tatha Ghose
FX Analyst
+44 20 7475 8399
tatha.ghose@commerzbank.com

In accordance with ESMA MAR requirements this report was completed 1/8/2024 06:45 CEST and disseminated 1/8/2024 06:45 CEST.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal view about the subject securities and issuers; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: This research report was prepared by Commerzbank AG, a company authorized to engage in securities activities in Germany and the European Economic Area (EEA). Commerzbank AG is not a U.S. registered broker-dealer and is therefore not subject to U.S. rules regarding the preparation of research and associated rules pertaining to research analysts. This document is not for distribution to retail customers. Any distribution of this research report to U.S. investors is intended for “major U.S. institutional investors” in reliance on the exemption from registration provided by Rule 15a-6(a)(2) of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”). Any U.S. recipient of this research report seeking to effect transactions to buy or sell securities, or related financial instruments based upon the information provided in this research report, may only do so through a Financial Industry Regulatory Authority (FINRA) registered broker-dealer. Commerz Markets LLC (CMLLC) is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. Commerzbank AG is a registered derivatives swap dealer with the Commodity Futures Trading Commission (CFTC), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. U.S. Person(s) and related Dodd-Frank relevant investors seeking to effect transactions in non-security based swaps based upon the information provided in this research report, may only do so through a CFTC registered swap dealer.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”) pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a “financial advisory service” within the meaning of the Financial Advisers Act, Chapter 110 of Singapore (“FAA”) and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313. Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People’s Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for eligible entities in the PRC. No-one else may rely on any information contained within this document. The products and services in this document only apply

Commerzbank Offices

Frankfurt	London	New York	Singapore
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000