adt_fx Weekly Review & Outlook – 28 July 2013

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General Theme/s

There appears to be a mid cycle re-balancing of Emerging Market – EM and Developed World – DW, economics induced by talk of QE Tapering atop the existing Capacity Constraints and socio-political and regulatory & economic Teething Problems that could well have been expected across EM. Again I would see this as entirely normal and not beyond the short to medium term to detract from the Broader almost Secular but at least Super-Cycle shift in Production, Productivity and Wealth from DW to LDW or EM. That begs the comment re Super Cycle. Commodities producers in particular have a myopic view of what constitutes the Super Cycle; That being it is all about Commodities prices. It is not and it is well beyond that, to the point of almost being Biblical in proportion – The Meek Inheriting the Earth. At the very least it is about a significant shift in Production, Productivity and Wealth on the basis of concepts such as GDP per person, Comparative Cost of Labor and General Cost of Production, that might be reflected in relative worldly positioning, the full cycle of which might need to be viewed over at least 200-300 years. It is almost as simple as Mean Reversion. Commodities and their prices are a side effect.

Either way, whilst EM Foreign Exchange may have lost some short to medium term appeal I believe there remains a broader theme to be revisited before long.

Foreign Exchange Markets have been two-directional – struggling to find direction or trend – coming and going without staying in either direction for long – skittish. I have found this to be the case in the last two weeks even beyond the most confused of weeks several weeks ago in relation to US Federal Reserve Meeting Minutes and other Commentary regarding QE Tapering – to be or not to be. If the last two weeks have been two-directional the worse week around Fed QE might have been termed multi-directional, if that is possible. Talking of which, this coming week brings more US Fed FOMC and further US GDP Q2 Reading #1. And by the way, I don't blame anyone for the confusion caused resulting from Fed activity and commentary. The state of the US (and Global) Economy and the nature of QE in particular, leave us in the situation where market participants are receiving Meeting Minutes at a time when there is significant Conjecture and Debate regarding the State Of Affairs. I am surprised Fed Meeting Minutes are as polite and well mannered as they appear; Or do we get the Edited version? It is a case of effectively too much information for the market when there is too little definitive and conclusive on Conditions and therefore on Policy. Big Ben himself has actually been very consistent in his views and comments and I personally rate his timing to be excellent. In any case we have seen what Kathy Liens' BK Asset Management appropriately termed High βeta FX.

In the mean while there is, from the immediate past week or so, confirming evidence of economic momentum rebuilding across the DW - EU, GB, Japan and the US. Accordingly EUR, GBP, and JPY have enjoyed stronger forces in at least the second half of July. USD remains a quandary.

USD

The US has seen recovering economic data stronger and for longer than the rest of the DW. I would term it the best of the Basket Case DW Economies. However, the impact of QE and market clout of the Fed etc, has seen the USD, by my calculations, to be something less than the best performing DW currency. This remains the case. It would appear the EU experiencing a slower rate of Recession is more likely to propel the EUR than the modest but growing and improving economic and structural (energy and technology) circumstances in the US are likely to propel the USD.

Having briefly expected a more consistent recovery in USD earlier this month, I am now wary of market expectation and treatment of QE, tapering of QE and more traditional qualitative monetary policy, and the likely impact on currency markets.

Basically the USD is uncertain about rising and possibly doesn't want to; The EUR does want to go up and only up.

EUR

The EUR behaviour is tough particularly if one, such as I, reads the economic and structural difficulties, along with longer term secular economic decline to be what it appears. At best the description – slower rate of recession appears most appropriate and the structural issue in force or emerging, of EU countries being nothing more than Labor providers to Germany or at least to German Capital is noteworthy. Nevertheless EUR has strength around at least USD, that I care not to argue with.

GBP

The UK has continued the economic gains that have been evident from at least the June data releases starting several weeks ago. Unfortunately there appeared some confusion and traps as the commencement of June data releases overlapped residual May releases. May was clearly less healthy. In the last several days however something changed – that being the GBP managed to find something more sustained in currency appreciation particularly against USD. Of the non-US DW economies the UK is probably showing the strongest recovery signs. Further the BOE seemed to put a halt to any QE expansion with some degree of unanimity.

There is supportive quantitative evidence suggesting GBPUSD rise can be sustained to levels somewhat higher than 1.54. Basic ppp modelling would indicate material rise.

JPY

While GBPUSD saw healthy rise, GBPJPY fell away in the face of perceptions of a recovering Japanese economy. The JPY is a little like EUR in that markets are friendly to it and want basically to push it up. I wrote several weeks ago, I would look to be short USDJPY but pending indications of the impact of economic policy (partly new) on Japanese economic direction. There is some tentative evidence of economic recovery but there is also a tendency for the market to overstate this. Example is the inflation data released in recent days which was boasted as a return to inflation in Japan. My reading is a little different and more tempered in outlook; That being that Core Inflation in June, month on month, was all of Zero Percent (0%) versus 0.2% in May. It actually fell – disinflation, at least without being Deflationary. By quirk of past an annual rise was recorded at around 0.4%.

In any event, the point is one would be wary about being short JPY at this stage of cycle. Expectations of the easy USDJPY Long and rising to 110 or 120 may be well overblown despite relative momentum in QE of Japan versus US and UK; But it is the latter re QE that would also leave me wary of being short USDJPY.

AUD – The Little Aussie Battler

The AUD finally won the week and finished on an upward tilt after gaining and then shedding once or twice through the last week or so in a range 0.899 – 0.93. A technical recovery, some sustained improvement in iron ore price (114 – 132) over the last three months), a levelling in other commodity prices, mixed feelings about a pre-election interest rate cut and so on, helping The Little Aussie Battler. I have mixed to negative views on this currency. I believe there will be further interest rate cuts as the economy faces an Australian Labour Party economic hangover as it usually does following several years of ALP economic mismanagement. There has been ample evidence for up to three years that the Mining Boom was not the answer for Australia. Policy makers ignored the limited national benefit it held let alone the detrimental effects it has had on the broader economy. Structurally the Australian economy has been noticeably weakened over the last six years. Reparation time and effort will be elongated and significant. I Do Not see the medium term trend for AUDUSD to be up.

EM

The broader EM trends we have discussed above. Leave for the short term despite interest rate rises across Brazil, India, Turkey etc. These are required given various issues such as Capacity Constraints, Inflation, Capital flows in the context of Tapering talk, etc, and are not necessarily permanently currency supportive.

MXN

Having said that I reiterate our preference for MXN but not right at this pricing of around 12.6 USDMXN, let alone timing. Mexican GDP for May came in at 1.7%p.a in the last week, while in the last two weeks it was reported that Mexican unemployment rose from 4.9% to just short of 5.1%.

As with GBPUSD, USDMXN valuation is forecast with some ppp and GDP-pp modelling to be significantly detached from current levels, indicating significant decline in USDMXN over the medium to longer term. In the short term however some Technical Analysis is suggesting USDMXN may revisit 13.0 and possibly higher.

CNY

Generally weak Chinese economic data, especially HSBC July Manufacturing PMI 47.7, against 48.2 expected and 48.2 previous. Other data similar trends and general suspicion as to quality and accuracy, let alone measurement technique and collection method of Chinese Data. Other measures re Lending Rate Floors etc of little real consequence. China.......yawn.

Other Matters Of Relevance

– Central Banks – Bad Banks?

I personally find it interesting that Central Banks generally in their expanded Balance Sheet – QE modes are sitting on extensive Securities Portfolios. With the prospect of medium to longer term, if not short term, interest rate rises globally, they face Securities Trading / Investment Losses and or FX losses, and or Gold value losses. Some evidence of these potential losses which encouraged me to recently describe the Central Banks, potentially but partly tongue in cheek, as the Bad Banks of the 2000 Teens, were seen in early July RBA Balance Sheet and Trading losses ($5B for June – July alone), and Singapore Central Bank $10.6B loss for 2012-13. I expect there will be more to come of this nature if not in the short term then medium to longer term as interest rates rise.

Quotable Quotes - from a Week that started with Great Expectations from Japanese Senate elections which fizzed, and had French MP's re-visiting WWII:

UK Business Secretary – BOE policy makers are like the Taliban.

Latest Prices

EURUSD	1.3276
GBPUSD	1.5380
USDJPY	98.256
USDCAD	1.0273
AUDUSD	0.9262
NZDUSD	0.8076
USDMXN	12.670

Week Ahead

31 July – US GDP Q2 Forecast 1.1% Previous (1.8%)

- US FOMC 0.25% / Tapering – QE Commentary
- US ADP Employment Change July Est 175K-180K Prev (188K)

1 Aug - CNY Official PMI Mfg July Est 49.8 Prev (50.1)

- CNY HSBC PMI Mfg July Est 47.7 Prev (48.2)
- EU, UK, US PMIs July
- BOE, ECB - Central Bank Meetings – Monetary Policy - Both 0.50%

2 Aug - US NFP July Est 185K Prev (195K)

- US NFPP July Est 190K Prev (202K)
- US Unemployment July Est 7.6% Prev (7.6%)

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