Standard Bank
Also trading as Stanbic Bank

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How to trade the markets

- The dollar is expected to grind slowly higher, hampered by the persistence of very low volatility.
- The euro has been spared from the impact of weak growth in the past by its strong balance of payments position. We believe that this support is starting to weaken.
- We look for euro/dollar to slide to 1.25 but this could take six months at the current pace.
- The Chinese renminbi should resist and dollar strength. We see a dollar/renminbi rate of 6.0 over the next year or so.
- The case for lower euro zone bond yields is a very solid one; that's not the case with US treasuries.
- The Bank of England is likely to lift its policy rate before the Fed. This might help the market cope when the Fed does finally hike, likely in just over a year's time.

G10 FX forecasts

	Current	1mth	3mth	6mth	12mth
EUR/USD	1.34	1.32	1.29	1.27	1.25
USD/JPY	102	101	102	105	112
GBP/USD	1.67	1.67	1.65	1.65	1.67

Source: Standard Bank Research, Reuters. *Survey refers to Reuters monthly survey of around 60 analysts

G10 rate forecasts

	Current	Q3	Q4	Q1	Q2
US	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
Euro	0.15	0.15	0.15	0.15	0.15
Japan	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1
UK	0.50	0.50	0.50	0.75	1.00

Source: Standard Bank Research, Reuters

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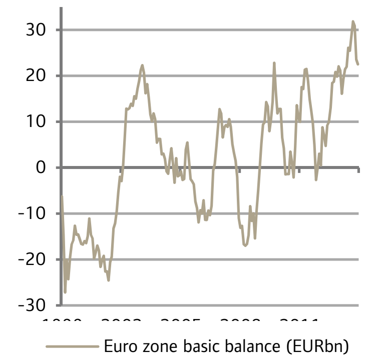
How to trade the FX market

Low volatility and limited directionality are likely to persist within the G10 currencies; especially the major currencies. We still expect euro/dollar to grind its way lower, with the dollar performing well elsewhere. The one exception could be the Chinese renminbi.

Grinding dollar strength expected

We expect the US dollar to grind its way higher against other G10 currencies. Against the euro, this should mean sub-1.30 levels in coming months, with 1.25 not out of range, come the end of the year. The danger for the euro is that the imposition of sanctions against Russia proves the tipping point that pushes the region into a new recession. Last week, we saw the German ZEW survey plunge in a way that’s only usually seen when the economy is on the verge of recession. And with Q2 GDP already negative at -0.2%, the economy is halfway to the dreaded ‘R’ word. This Thursday’s PMI surveys for euro zone manufacturing and services industries could prove important in determining whether the whole region could slip below the zero growth line over the remainder of the year.

Figure 1: Starting to turn down?

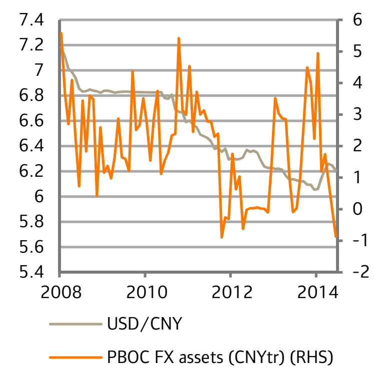


Source: Ecowin

Of course, recession is nothing new for the euro zone and, in spite of the weakness, the euro has not always slumped. We feel that the main reason for this has been the robustness of the balance of payments. On the trade side, the slump in import demand and improvement in competitiveness in the periphery countries has kept trade performance very strong. While, in the financial accounts, overseas investors have piled into euro zone bonds in recent years, attracted by relatively high yields against other G10 peers.

But, looking ahead, we’re not sure that these props for the euro will continue to provide such support. The sanctions against Russia could clearly weigh on trade while, on the financial account, the yield pick-up in the euro zone periphery is very small now while, on equities, there are some signals from fund manager surveys that overseas investors are growing frustrated with the economic recovery story. The basic balance (the sum of the current account plus direct investment and securities flows) has recently started to turn down on a 1-year moving average basis (Figure 1) and, if this continues, we suspect that the euro will fall as well. A stronger dollar against the euro should be mirrored by dollar appreciation elsewhere although, like the euro, this is seen occurring at a snail’s pace. Things might get more interesting for the dollar when the Fed gets closer to rate hikes – but we still think that’s a year away.

Figure 2: A lower USD/CNY?



Source: Ecowin

One exception to the trend of a stronger dollar might be seen in the Chinese renminbi. It is noticeable that after a sharp rise in dollar/renminbi in Q1 this year, Q2 has been more stable – and the start of Q3 has seen the dollar slip sharply against the Chinese currency. We believe that the dollar will continue to slide back to the levels we saw at the start of the year – around 6.0.

The recent trend of renminbi strength has been accompanied by the changes we have seen in the PBOC’s FX assets. Figure 2 shows how FX assets have slipped sharply in recent months which, we feel, is indicative of the fact that the authorities have been prepared to see the renminbi rise within the context of the over-riding plan to step back from market manipulation in order to allow the currency to become more market-determined.

It is our view that the absence of market involvement by the PBOC allows the renminbi to rise by virtue of the fact that China’s balance of payments position is so strong. Chinese leaders might try to suggest that the renminbi is at an ‘equilibrium’ level right now but our suspicion is that ‘equilibrium’ for USD/CNY is still a good deal lower than it is right now; certainly below the 6.0 level.

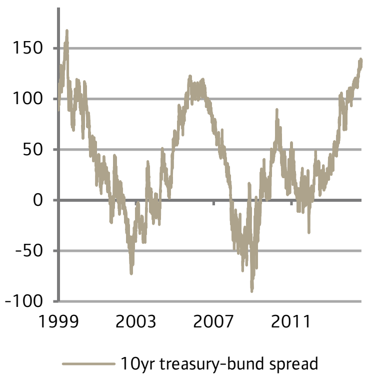
How to trade the fixed income market

We remain convinced that yields in the euro zone can still fall further, but less convinced that the US and UK can see much lower yields as both central banks lay out the groundwork to lift policy rates. Rate hikes probably won't occur until next year but that should still limit the extent to which yields can fall this year.

External factors of importance for treasuries

US bond yields continue to slide although we feel this is more to do with things like geopolitical strains and the fall in yields in the euro zone, than particularly adverse economic developments in the US. In our view, the position of the US economy and the outlook for Fed policy suggest that yields should be stable-to-stronger, not lower. But clearly geopolitical strains are high, especially with regard to Russia, and the 'pull' from lower euro zone yields seems quite forceful as well. The latter is one reason why we've tended to prefer spread trades to outright positions, as shown by our 200 bps target for the 10-year treasury-bund spread. Our thinking on this in past months has been that 10-year Bund yields deserve to be around 1%, given the weakness of the economy and the low level of inflation. While, for the US, we've thought that 3% was about the 'right' level for 10-year treasuries in the present environment.

Figure 3: Target 200 bps



Source: Ecowin

But clearly, as the year has rolled on, only one side of this view has performed. For while the 10-year spread has widened as anticipated, it is only Bunds that have performed as expected, falling to 1%, while 10-year treasuries have drifted away from the 3% level. Looking ahead, we think that 10-year bund yields can easily hit 0.75% and even 0.5% is possible if the economy falls into a new recession – and deflation – at the same time. Such events would probably help pull 10-year treasuries down to the 2% level, but the spread should still widen in our view on most of the likely scenarios for the euro zone and US.

While external factors have had a big role to play in pulling treasury yields lower, we can't ignore the fact that domestic US developments have played a part. This is not so much to do with the ebb and flow of US data, but more to do with the interpretation put on the data flow. For instance, the argument that the US (and perhaps others) are going through a 'secular stagnation' that leaves real yields considerably lower than averages seen in the past, has gained traction, even with some policymakers. Fed Chair Yellen will talk about some of these issues, as they relate to the labour market, in her speech at the Jackson Hole conference on Friday. Yellen's comments have a habit of sounding a bit more dovish and, although the market is accustomed to this, her comments may still aid the treasury market. Our current thinking is still that the Fed won't start to lift rates until Q3 next year, and we'd be surprised if Yellen were to hint at something sooner in her comments later this week.

The Bank of England should hike first

The Bank of England should hike rates before the Fed. At the moment, we are reckoning on Q1 next year for the first base rate hike. BoE Governor Carney said in a weekend interview that the prospect of being the first to move (among the big 4 central banks) holds no fears for the Bank. We feel that if financial markets experience the 'dry run' of the BoE lifting policy rates first it might actually make for a calmer global market reaction when the Fed does, eventually, start to lift its own rates.

Watch the Riksbank

Much has been discussed with respect to the performance of central banks in the post credit-crunch world. Those that have expanded policy vigorously, such as the Fed, have faced accusations by some politicians that they have played fast and loose with inflation. Others, that have been more cautious, like the ECB, have been accused of being too stingy. One interesting case of this is in Sweden. Elections due next month could show the power of this pressure as the opposition parties have pressed for a change in the Riksbank's mandate – to include employment as well as inflation. If it wins the elections and gets its way it could not only lower Swedish rates but also act as a bit of a wake-up call for other central banks around the world.

G10 forecasts

G10 economic forecasts

Country	GDP		CPI	
	2014	2015	2014	2015
US	2.1	3.1	1.9	2.2
Eurozone	0.6	1.0	0.6	1.0
Japan	1.0	1.8	2.7	1.5
UK	3.0	2.5	1.8	1.8
Switzerland	2.0	2.2	0.1	0.4
Canada	2.0	2.5	1.5	1.7
Australia	2.9	3.0	2.7	2.5
NZ	3.5	3.0	1.7	2.5
Sweden	2.0	2.2	0.1	1.0
Norway	2.0	1.9	2.0	1.8
China	7.1	6.9	3.0	3.3

Source: Standard Bank Research

G10 FX forecasts

	Current	1 month		3 months		6 months		1 year		2 years	
		forecast	forward	forecast	forward	forecast	forward	forecast	forward	forecast	forward
Dollar rates											
EUR/USD	1.34	1.32	1.34	1.29	1.34	1.27	1.34	1.25	1.34	1.20	1.34
USD/JPY	102	101	102	102	102	105	102	112	102	120	101
GBP/USD	1.67	1.67	1.67	1.65	1.67	1.65	1.67	1.67	1.66	1.71	1.65
USD/CHF	0.90	0.92	0.90	0.95	0.90	0.98	0.90	1.04	0.90	1.08	0.89
USD/CAD	1.09	1.09	1.09	1.10	1.09	1.15	1.09	1.20	1.10	1.30	1.10
AUD/USD	0.93	0.91	0.93	0.90	0.93	0.85	0.92	0.80	0.91	0.74	0.90
NZD/USD	0.85	0.85	0.84	0.84	0.84	0.81	0.83	0.75	0.82	0.7	0.79
USD/SEK	6.85	7.05	6.85	7.25	6.85	7.48	6.86	7.40	6.86	7.50	6.83
USD/NOK	6.15	6.25	6.15	6.36	6.17	6.38	6.19	6.40	6.22	6.25	6.26
USD/CNY	6.14	6.16	6.16	6.15	6.19	6.12	6.22	6.10	6.25	6.00	6.29
Euro rates											
EUR/JPY	137	133	137	132	137	133	137	140	137	144	135
EUR/GBP	0.80	0.79	0.80	0.78	0.80	0.77	0.80	0.75	0.81	0.70	0.81
EUR/CHF	1.21	1.22	1.21	1.23	1.21	1.25	1.21	1.30	1.21	1.30	1.19
EUR/CAD	1.46	1.44	1.46	1.42	1.46	1.46	1.46	1.50	1.47	1.56	1.48
EUR/AUD	1.44	1.45	1.44	1.43	1.45	1.49	1.46	1.56	1.48	1.62	1.50
EUR/NZD	1.58	1.55	1.58	1.54	1.59	1.57	1.61	1.67	1.64	1.71	1.70
EUR/SEK	9.17	9.30	9.17	9.35	9.18	9.50	9.18	9.25	9.20	9.00	9.18
EUR/NOK	8.23	8.25	8.24	8.20	8.26	8.10	8.29	8.00	8.35	7.50	8.41
	Current	**1 month**		**3 months**		**6 months**		**1 year**		**2 years**	
		forecast	**survey***	**forecast**	**survey***	**forecast**	**survey***	**forecast**	**survey***	**forecast**	**survey***
Dollar rates											
EUR/USD	1.34	1.32	1.34	1.29	1.33	1.27	1.30	1.25	1.28	1.20	N/A
USD/JPY	102	101	103	102	103	105	105	112	108	120	N/A
GBP/USD	1.67	1.67	1.69	1.65	1.70	1.65	1.69	1.67	1.68	1.71	N/A
USD/CHF	0.90	0.92	0.91	0.95	0.92	0.98	0.94	1.04	0.97	1.08	N/A
USD/CAD	1.09	1.09	1.09	1.10	1.09	1.15	1.10	1.20	1.12	1.30	N/A
AUD/USD	0.93	0.91	0.93	0.90	0.92	0.85	0.91	0.80	0.89	0.74	N/A
Euro rates											
EUR/JPY	137	133	138	132	137	133	137	140	138	144	N/A
EUR/GBP	0.80	0.79	0.79	0.78	0.78	0.77	0.77	0.75	0.76	0.70	N/A
EUR/CHF	1.21	1.22	1.22	1.23	1.22	1.25	1.22	1.30	1.24	1.30	N/A

Source: Standard Bank Research, Reuters. *Survey refers to Reuters monthly survey of around 60 analysts

G10 forecasts

G10 rate forecasts

		2014		2015			
	Current	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
US							
Policy rates	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0.25-0.5	0.5-0.75
3mth cash	0.75	0.35	0.40	0.45	0.50	0.65	0.70
2yr yield	0.42	0.50	0.75	0.90	1.20	1.40	1.50
10yr yield	2.37	2.50	2.75	2.90	3.15	3.25	3.50
Eurozone							
Policy rates	0.15	0.15	0.15	0.15	0.15	0.15	0.15
3mth cash	0.20	0.20	0.22	0.25	0.28	0.30	0.28
2yr yield	-0.01	-0.05	-0.10	0.00	0.20	0.30	0.30
10yr yield	1.00	0.90	0.75	0.85	1.00	1.40	1.60
Japan							
Policy rates	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1
3mth cash	0.23	0.15	0.20	0.20	0.25	0.25	0.25
2yr yield	0.07	0.05	0.10	0.20	0.30	0.35	0.40
10yr yield	0.50	0.45	0.50	0.70	0.90	1.00	1.10
UK							
Policy rates	0.50	0.50	0.50	0.75	1.00	1.25	1.50
3mth cash	0.71	0.75	0.80	0.85	1.10	1.60	1.75
2yr yield	0.72	0.75	1.00	1.20	1.40	1.80	1.90
10yr yield	2.41	2.55	2.70	2.85	3.05	3.40	3.50
Switzerland							
Policy rates	0.13	0.13	0.13	0.13	0.13	0.13	0.13
10yr yield	0.47	0.45	0.50	0.75	0.85	0.90	1.00
Canada							
Policy rates	1.00	1.00	1.00	1.00	1.00	1.25	1.50
10yr yield	2.04	2.10	2.25	2.35	2.65	2.85	3.00
Australia							
Policy rates	2.50	2.50	2.50	2.50	2.50	2.75	3.00
10yr yield	3.36	3.50	3.60	3.75	4.00	4.20	4.25
NZ							
Policy rates	3.50	3.50	3.50	3.75	3.75	4.00	4.25
10yr yield	4.13	4.30	4.50	4.80	5.00	5.05	5.10
Sweden							
Policy rates	0.25	0.25	0.15	0.15	0.15	0.25	0.25
10yr yield	1.60	1.50	1.40	1.35	1.50	1.75	2.00
Norway							
Policy rates	1.50	1.50	1.25	1.25	1.25	1.50	2.00
10yr yield	2.29	2.30	2.40	2.60	2.80	3.00	3.20

Source: Standard Bank Research, Reuters

G10 rate forecasts

	2014				2015							
	Q3		Q4		Q1		Q2		Q3		Q4	
	forecast	**survey***	**forecast**	**survey***	**forecast**	**survey***	**forecast**	**survey***	**forecast**	**survey***	**forecast**	**survey***
US	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0.25	0.25-0.5	0.50	0.5-0.75	1.00
Eurozone	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Japan	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1
UK	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50

Source: Standard Bank Research, Reuters. * The survey refers to the Reuters monthly survey of analysts

G10 calendar

G10 calendar

Monday 18

Time		Event	Period	Survey	Actual	Prior	*Risk
00:01	UK	Rightmove House Prices MoM	Aug	--	-2.90%	-0.80%	
10:00	EC	Trade Balance SA	Jun	--	13.8B	15.2B	
15:00	US	NAHB Housing Market Index	Aug	53		53	-
23:45	NZ	PPI Output QoQ	2Q	--		0.90%	
23:45	NZ	PPI Input QoQ	2Q	--		1.00%	
	CH	Foreign Direct Investment YoY	Jul	0.80%		0.20%	=

Tuesday 19

Time		Event		Survey	Actual	Prior	*Risk
06:30	JN	Nationwide Dept Sales YoY	Jul	--		-4.60%	
09:00	EC	ECB Current Account SA	Jun	--		19.5B	
09:30	UK	CPI MoM	Jul	-0.20%		0.20%	-
09:30	UK	CPI YoY	Jul	1.80%		1.90%	-
09:30	UK	PPI Input NSA MoM	Jul	-0.90%		-0.80%	=
09:30	UK	PPI Output NSA MoM	Jul	0.10%		-0.20%	=
09:30	UK	PPI Output Core NSA MoM	Jul	0.10%		0.00%	=
13:30	US	CPI MoM	Jul	0.10%		0.30%	=
13:30	US	CPI Ex Food and Energy MoM	Jul	0.20%		0.10%	-
13:30	US	Housing Starts	Jul	970K		893K	+
13:30	US	Building Permits	Jul	1000K		963K	+

Wednesday 20

Time		Event		Survey	Actual	Prior	*Risk
00:30	AU	RBA's Stevens Semi-Annual Testimony					
00:50	JN	Trade Balance Adjusted	Jul	-¥761.3B		-¥1080.8B	-
00:50	JN	Exports YoY	Jul	3.8		-2	-
00:50	JN	Imports YoY	Jul	-1.5		8.4	+
07:00	GE	PPI MoM	Jul	0.00%		0.00%	-
09:30	UK	Bank of England Minutes					
10:00	EC	Construction Output MoM	Jun	--		-1.50%	
11:00	UK	CBI Trends Total Orders	Aug	--		2	
14:00	NO	Norges Bank's Olsen speaks					
19:00	US	Fed Minutes from July 29-30 FOMC Meeting					

Thursday 21

Time		Event		Survey	Actual	Prior	*Risk
02:45	CH	HSBC China Manufacturing PMI	Aug P	51.6		51.7	-
08:30	SW	Unemployment Rate SA	Jul	--		8.00%	
08:30	GE	Markit/BME Germany Manufacturing PMI	Aug P	51.5		52.4	-
08:30	GE	Markit Germany Services PMI	Aug P	55.5		56.7	+
09:00	NO	GDP QoQ	2Q	0.40%		0.30%	-
09:00	NO	GDP Mainland QoQ	2Q	0.70%		0.50%	-
09:00	EC	Markit Eurozone Manufacturing PMI	Aug P	51.3		51.8	-
09:00	EC	Markit Eurozone Services PMI	Aug P	53.7		54.2	=
09:30	UK	Retail Sales Incl. Auto MoM	Jul	0.40%		0.10%	-
09:30	UK	PSNB ex Interventions	Jul	0.5B		11.4B	=
13:30	US	Initial Jobless Claims	Aug-16	--		311K	
14:45	US	Markit US Manufacturing PMI	Aug P	55.7		55.8	+
15:00	US	Philadelphia Fed Business Outlook	Aug	20		23.9	+
15:00	US	Existing Home Sales	Jul	5.00M		5.04M	+
15:00	EC	Consumer Confidence	Aug A	-9.1		-8.4	+
15:00	US	Leading Index	Jul	0.60%		0.30%	=
21-23	US	Kansas Fed's Jackson Hole symposium					

Friday 22

Time		Event		Survey	Actual	Prior	*Risk
13:30	CA	Retail Sales MoM	Jun	0.40%		0.70%	-
13:30	CA	Retail Sales Ex Auto MoM	Jun	0.60%		0.10%	-
13:30	CA	CPI NSA MoM	Jul	-0.10%		0.10%	=
13:30	CA	CPI Core MoM	Jul	0.00%		-0.10%	=
15:00	US	Fed's Yellen speaks on the labour market					

Source: Standard Bank Research, Bloomberg, *Risk reflects our view on whether data is likely to be above expectations (+), below (-), or in line (=).

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This material is non-independent research. Non-independent research is a "marketing communication"

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