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fxPoetry

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# Woebegone Tales

In England and Scotland and Wales
The Minister, Prime, has travails
The energy crisis
Of rocketing prices
Has publicized woebegone tales

And so, she is ready to spend
As much as she needs, without end
At least forty bill
To foster goodwill
And growth in the UK, defend

Well, it's official, Liz Truss is the new Prime Minister of the UK, winning the Tory leadership vote 57% - 43%. This was widely expected by the punditry as well as the markets, although the reaction we have seen has been a relief rally in the pound. Yesterday, while most of us were enjoying (I hope) the Labor Day holiday, the beleaguered pound traded as low as 1.1444, barely above the Covid lows, although it has since rebounded nicely. The key concerns seem to be that Truss is planning significant tax cuts to support the economy with no obvious financing source other than borrowing the necessary funds to pay for them. This morning, she proffered her energy plan, at least the framework, in which the government would cap household energy bills at £2000 per annum with the government paying the difference to the suppliers. The price tag here is estimated at £40 billion this winter, and this is on top of her mooted tax cuts.

In addition to the fiscal issues, there remains the Brexit/Northern Ireland problem where the UK has decided it is unhappy with the compromise reached to complete the trade deal and is considering legislation that will essentially nullify the process. In this event, it seems highly likely that the EU will respond by essentially tearing up the trade deal and the UK will be left with no framework other than the basic WTO tariff schedules. This, too, has been weighing on the pound as the assumption is the UK economy will suffer greatly in this event. One offset to this problem is the fact that the UK's energy policy, as daft as it has been, is a far sight better than that of the EU and while the Truss plan highlighted above costs a lot, it is far less than it would be if the UK were still part of the EU. That plan (if it can be called such) seems likely to have a €2 trillion negative impact on the economy. It is things like this that inspire the bears in both euros and pounds.

In China, no change has been made
And President Xi won't be swayed
It's zero or bust
As he won't adjust
With lockdowns now widely arrayed

Once again, a random case of asymptomatic Covid has the Chinese government scrambling to prevent any further spread. With more than 21 million people in Chengdu, and a total of some 65 million people around the country suffering from restrictions on their activity, President Xi Jinping is doubling down on his efforts to show that this policy, even if it has a negative impact on economic activity, is the correct one in the long run. I fear his task is getting harder by the day. In fact, for those of you worried about a Chinese invasion of Taiwan, it seems to me that if this is the decision process, there is very little about which to worry. While the Chinese may be practiced at preventing movement of its people, given the underlying flaws in the thesis, it is certainly reasonable to question their strategic thinking.

At any rate, more lockdowns in China leads to weakening activity. One consequence is that the property sector, already a disaster, will feel even more strains, and we are very likely to see further policy ease, both fiscal and monetary, from the government. In the end, the relief valve best suited to adjust for these policy differences with the West, and particularly with the US, is the renminbi's exchange rate. Since we left of Friday afternoon, CNY has fallen -0.9% and is fast approaching 7.00. It seems pretty clear that the PBOC has gotten more comfortable with a weaker currency at this stage, and many pundits are targeting the 2019 highs of 7.18 as a viable outcome. This seems reasonable and, depending on how the Fed continues its tightening regime, could well be just a waystation to a much firmer dollar. Given the opposite direction of travel with respect to monetary policies, large movement seems likely.

So, as we exit the summer markets, and with those two stories front of mind, let's take a look at markets. Somewhat remarkably, risk appetite seems to be whetted this morning as although the Nikkei (0.0%) and Hang Seng (-0.1%) showed limited movement, Shanghai (+1.3%) clearly benefitted directly from further policy ease discussions. Europe (DAX +1.0%, CAC +0.5%, UK +0.2%), too, sees something of benefit today, although it certainly doesn't appear to be economic in nature. The only data we saw today has been German Factory Orders (-1.1%) and German Construction PMI (42.6), both of which were quite weak and continue to trend lower. Perhaps it is the idea that the EU government is going to spend a fortune to support the economy that is encouraging the buyers. Or perhaps it is simply some short covering. But I would argue the direction of travel is still lower. As to the US, futures are marginally higher at this hour (+0.35%), but already falling from overnight highs.

Treasury yields have pushed higher again, +4.4bps, recouping most of Friday's 6bps of losses. It seems that the NFP data inspired some that the Fed would be less aggressive, something that played out in the Fed funds futures markets as well where the peak remains in March 2023 but is now just 3.87% compared to 3.95% ahead of the data. Gilts (+1.0bp) are also edging down but yields on the continent have tumbled, just recently, with Bunds (-6.5bps), OATs (-7.5bps) and BTPs (-7.7bps) after some dovish commentary from Portuguese ECB Council Member Mario

Centeno. It seems that after a wave of hawkishness, the doves are pushing back. In the end, Madame Lagarde is the key, and it strikes me that she will be more timid than the 75bp crowd has been pushing.

Commodity prices are under some pressure, or certainly energy prices are with oil (-2.9%) and NatGas (-2.0% in US, -10.75% in Europe) all lower. The hardest thing to figure out in this market is what exactly this price action represents. Trading activity has been extremely low and just this morning, Norwegian energy giant Equinor explained that they expected margin calls to result in a $1.5 trillion bill for the energy sector, something that will not be able to be achieved without government intervention. Adding to the confusion is the ongoing price cap discussion for Russian oil and NatGas as well as the fact that Russia has closed the Nordstream 1 pipeline. Trading this is not for the faint of heart.

Metals markets, though, are much less troubled with gold (+0.2%) edging higher alongside copper (+0.25%) although aluminum (-0.3%) continues to be whipsawed by smelter closures due to high electricity costs.

Finally, the dollar is mixed this morning, when compared to where we left it Friday afternoon. The yen (-1.1%) continues to fall, and fall sharply, and there is no indication the BOJ is going to care about it too much. Perhaps a few jabs of verbal intervention, but certainly no policy adjustments. AUD (-0.4%) is the next worst as the RBA's 50bp rate hike last night did nothing to assuage fears it remains behind the inflation curve. On the plus side, NOK (+0.7%) is higher despite the recent decline in oil and GBP (+0.65%) has benefitted from more political certainty.

Aside from the renminbi, KRW (-0.7%) is falling sharply again and now back to levels last seen during the GFC however it remains a long way from the peak in USDKRW seen during the Asia crisis in 1998. CLP (-0.6%) is softer after the populace rejected the new constitution, although it has been gaining a great deal of ground since it became clear that would be the result of Sunday's referendum. The document was a laundry list of interventionist policies that the market saw has being extremely negative for the economy. On the plus side, ZAR (+0.7%) is benefitting from a somewhat better than expected GDP reading this morning.

Data this week is limited and includes:

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| Today | ISM Services | 55.5 |
| Wednesday | Trade Balance | -$70.3B |
| | Fed's Beige Book | |
| Thursday | Initial Claims | 240K |
| | Continuing Claims | 1438K |
| | Consumer Credit | $33.0B |

Source: Bloomberg

In addition, we hear from seven more Fed speakers including Chairman Powell on Thursday. The market is still torn between 50bps and 75bps at the next meeting although barring a collapse in CPI next week, I expect 75bps. And we hear from the ECB and Madame Lagarde on Thursday with their decision, so the 50/75 debate is ongoing there as well.

At this stage, nothing has changed my view that the dollar remains the place to be and I would be taking advantage of sell-offs to add to hedges.

Good luck and stay safe
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