SMBC Capital Markets, Inc.

fxPoetry

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The Dollar to Fly

The jobless report Friday past
Was stronger than had been forecast
But under the hood
It wasn't so good
As losses of workers were vast

And later this week, CPI
Is forecast to print very high
So, look for the Fed
More hikes to imbed
And look for the dollar to fly

The NFP report on Friday certainly surprised markets with a much higher than expected headline print as well as a maintenance of the 3.6% Unemployment Rate. For all those pundits calling for a recession (present company included) it remains difficult to make an iron clad case yet. But as will always be the case with any major report, not everything was rosy in Friday's release. The key concern, aside from the fact that wage growth continues to run well below the inflation rate, is that the Household Survey, the part of the package that helps determine the Unemployment Rate, actually saw a decline of about 350K jobs, a far cry from the NFP's +372K. Also, keep in mind that the revisions to previous months' NFP data were lower by 74K, so when taking all this into account, the news was not an unadulterated positive.

One other thing to keep in mind is that the NFP report is the most backward-looking data that we receive each month, with the implication being that whatever we see is indicative of what has already happened, not a forecast of what is upcoming. On the labor front, the weekly Initial Claims data is far more useful as a harbinger of the future, especially when one looks at its trend on a 4-week or 8-week moving average. And the story here is a bit less positive as these numbers have been trending higher since mid-March and are recently back above levels seen prior to Covid's interruptions.

But, if you are Jay Powell, and you are desperate to raise rates to fight inflation, this was a fantastic report. You may recall his comments after the June FOMC meeting and at the Humphrey Hawkins testimony about how strongly the economy is performing and how it can withstand higher interest rates. Since most people, especially members of Congress, don't really understand the nitty-gritty details of the data, he will be able to point to the headline and say, see, we have more work to do. In my mind, this data has cemented a 75bp rate hike at the meeting later this month and if anything, depending on Wednesday's CPI print, don't be surprised to hear talk of 100bps. The current median forecast for headline CPI is 8.8%, but if it prints at 9.0% or higher, a distinct possibility, be ready for that pivot.

With the hawkish viewpoint back in the ascendancy, it can be no surprise that the dollar is at it again, rising sharply against all comers today and printing at multi-decade highs vs. both the euro (-0.75%) and the yen (-0.7%) although neither of these were the worst performers in the G10,. That dubious distinction belongs to NOK (-1.1%) and AUD (-1.1%) with both feeling the pain of weaker commodity prices, notably oil (-2.3%) and copper (-1.85%).

So, what happened to the recession talk that was making the rounds last week? Apparently, one good payroll number is all you need to alter the narrative. While Fed funds futures are still pricing in rate cuts for the middle of next year, they are pricing in even more rate hikes for this year. Perhaps the best way to describe the situation is that there is ample confusion around the near-term views with multiple ideas as to how things will evolve. Arguably, this is the best possible situation as it implies that there are investors and traders with positions favoring both bullish and bearish moves in every market, and so neither side will be overly excessive. Markets tend to be much healthier when there are both buyers and sellers than when one side massively dominates.

So, let's take a look at markets overall, where risk has definitely lost its mojo. In Asia, only the Nikkei (+1.1%) managed to rally after the ruling LDP won a landslide victory in yesterday's elections and the market has taken that to mean approval of the BOJ's ongoing ultra-easy monetary policy. But the Hang Seng (-2.8%) and Shanghai (-1.3%) both suffered on news of an increase in Covid cases and further shutdowns there. Macau closed its casinos for a week and Hong Kong saw a surge to more than 6000 cases daily, severely stressing their health care facilities. In addition, the city-state is now looking at adopting the Chinese covid system tracking travel and restricting movement of those who test positive or come into close contact with someone who has. It seems like there could be further weakness here if things shut down again.

In Europe, red is also the color of the day, with the DAX (-0.8%), CAC (-0.65%) and FTSE 100 (-0.3%) all under pressure. The continent is stressing from the shutdown of the NordStream 1 pipeline for routine maintenance for 10 days. The concern is that Russia may choose not to reopen the taps and add dramatically more economic pressure on the EU as a means of getting his way in Ukraine. Consider that if Russian natural gas no longer flows into Europe, Germany is likely to suffer a major economic hit, upwards of 5% of economic growth being destroyed, and Europe will almost certainly head into a recession. And in the meantime, the ECB is still sitting on negative interest rates and QE. It is not hard to make the case that the euro could fall MUCH further, so hedgers beware. Finally, US futures are under pressure as well this morning, with all three major indices lower by about -0.4%.

Bond yields are lower across the board with Treasuries (-2.4bps) giving back some of Friday's yield gains although the curve remains a few basis points inverted for the 4th consecutive day, not a good sign for the future. European sovereigns show declines of 5.1bps in Bunds, 6.5bps in

OATs and 3.5bps in Gilts, with the entire continent rallying. The Bund-BTP spread remains well-behaved at 194bps, but we must continuously watch that for clues as to the ECB's next moves.

As mentioned, commodity prices are under pressure, except for NatGas (+4.4%) which is being whipsawed by the timing of the reopening of the Freeport LNG plant in Texas and the resumption of LNG exports to Europe. This will become especially crucial should Russia not reopen the NS1 pipeline. Gold (-0.3%) continues to drift lower while aluminum (-0.3%) is also softer this morning as fears over another Chinese shutdown far outweigh hope for stronger US growth. And food is in demand this morning with 1% gains in all the major grains.

As to the dollar, we have already discussed the weakest performers in the G10 with CHF (-0.4%) actually the strongest of the day. The pound (-0.65%), though, is an interesting story as this weekend saw the beginning of the leadership contest in the Tory party to determine who will be the next PM. At this point, 15 people have declared interest including BoJo's Chancellors and Foreign Secretary. The pound's prospects continue to deteriorate as there will be no fiscal policy help anytime soon, and so things are entirely reliant on the BOE, not a happy situation. In the EMG bloc, HUF (-1.55%) and PLN (-1.35%) are the worst performers but really all of EEMEA is under severe pressure on the back of the euro's weakness. APAC currencies also fell, but not nearly as much and MXN (-0.6%) is feeling the weakness of oil as well as the dollar's broad strength.

Data-wise, there are two big numbers this week, CPI and Retail Sales, and we hear from a number of Fed speakers as well.

Tuesday	NFIB Small Biz Optimism	92.5
Wednesday	CPI	1.1% (8.8% Y/Y)
	-ex food & energy	0.6% (5.7% Y/Y)
	Fed's Beige Book	
Thursday	Initial Claims	235K
	Continuing Claims	1380K
	PPI	0.8% (1.07% Y/Y)
	-ex food & energy	0.5% (8.2% Y/Y)
Friday	Empire Manufacturing	-2.0
	Retail Sales	0.9%
	-ex autos	0.7%
	IP	0.1%
	Capacity Utilization	80.6%
	Business Inventories	1.3%
	Michigan Sentiment	50.0

Source: Bloomberg

On top of all that, Williams, Barkin, Waller, Bostic and Bullard are all on the schedule this week, with a lot of hawkishness in that group. This could be especially interesting since the hawks all speak after the CPI print, so a high number could easily have an impact on their views.

Nothing has changed the narrative at this point, with the Fed still the leader of the pack of major central banks and the dollar benefitting accordingly. With the skyrocketing price of NatGas in Europe, Germany, which has run a trade surplus for the past 31 years has fallen into deficit, as has Japan. It's the beginning of earnings season as well, so any shortfalls there are likely to continue to weigh on risk assets and support the dollar further.

Good luck and stay safe
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The author is a salesperson in SMBC Capital Markets, Inc.
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