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INFLATION OUTLOOK
BRIEFING NOTE

Aug. 11th /// 2021

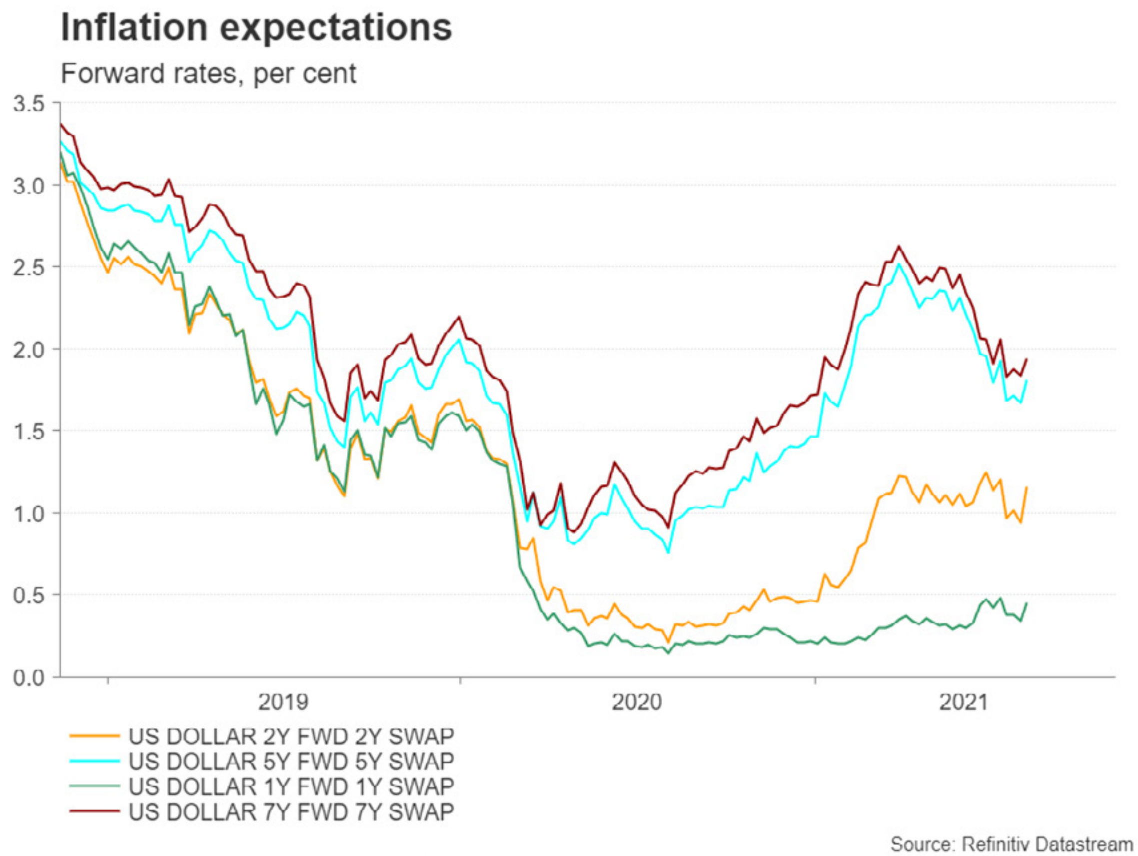
"FED walks a tightrope between Jobs and Inflation?"

Pace of US CPI inflation to test dollar bulls – Forex News Preview

While the Fed has distinctly stated that a potential shift to monetary tightening is strictly conditional on whether the US labor market will make significant progress, US CPI inflation figures could still be worth watching on Wednesday at 12:30 GMT. Forecasts are for a minor slowdown in July's figures, which makes any deviations possible. An upside surprise could add pressure for monetary tightening as soon as September, providing more fuel to dollar bulls and vice versa.

Inflation expectations remain below 2.0%

According to forward swap rates, inflation expectations have diminished from recent peaks, signaling that investors have likely swallowed the Fed's excuse of transitory inflation, with forecasts for the next year and the following two years remaining below 2.0%, despite the latest pickup.



Inflation spikes not a worry anymore for Fed

The Fed's favorite inflation measure, the core PCE index, has been up and running since April, marking highs after highs above 2.0%, which was the central bank's upper limit before the switch to a more flexible targeting. The core CPI inflation followed a similar pattern, but the pace of increases was steeper, leading the gauge to a 30-year high of 4.5% year-on-year in June, while the broader headline CPI clocked in even higher at 5.3% y/y.

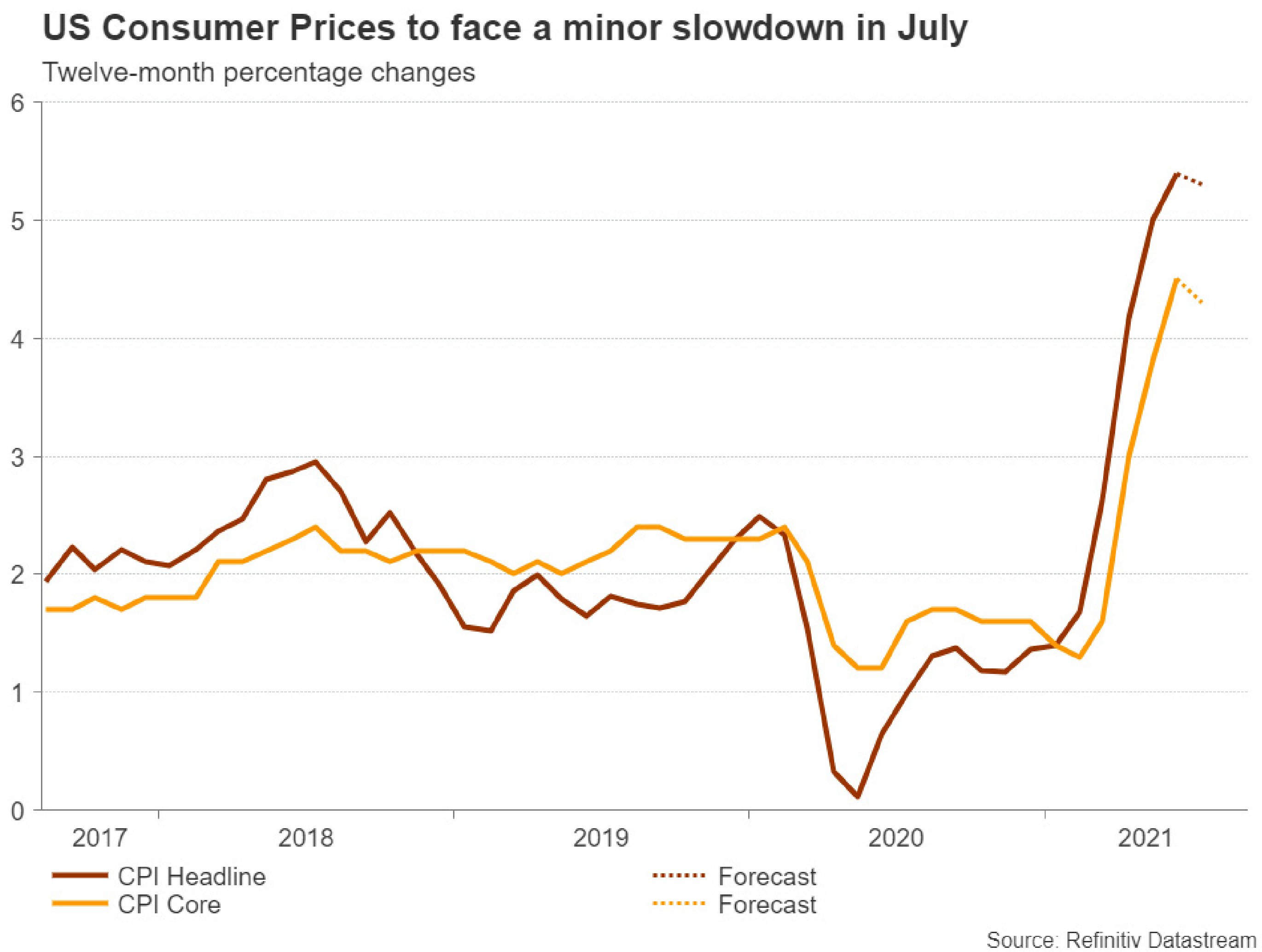
Under other circumstances, the Fed would have immediately abandoned its ultra-easy stimulus programs with scope to press inflation back to the 2.0% target. But this is not the case anymore. Its new inflation approach is now allowing prices to heat above 2.0% for some time until they average around this threshold in the medium term before any move to policy tightening takes place. On top of this, the central bank believes that the spiral in prices is a transitory phenomenon underpinned by the pandemic's blues, implying that once the economy returns to normal life and supply constraints vanish, price growth would pull back below 2.0%.

The above reasoning is justifying the dollar's muted reaction to inflation numbers over the past few months. Perhaps, as long as the Fed is not sweating and the labor market remains the elephant in the room, investors could be less sensitive to any inflation numbers. However, if the jobs data reach the desired level in the next few months and inflation remains stuck at high levels, forcing the Fed to bring forward any bond tapering plans, the dollar could get an extra boost.

Another interesting scenario would be if inflation loses steam as base effects fade, but consumer prices remain at high levels, weighing on demand for products and services. But this is another story!

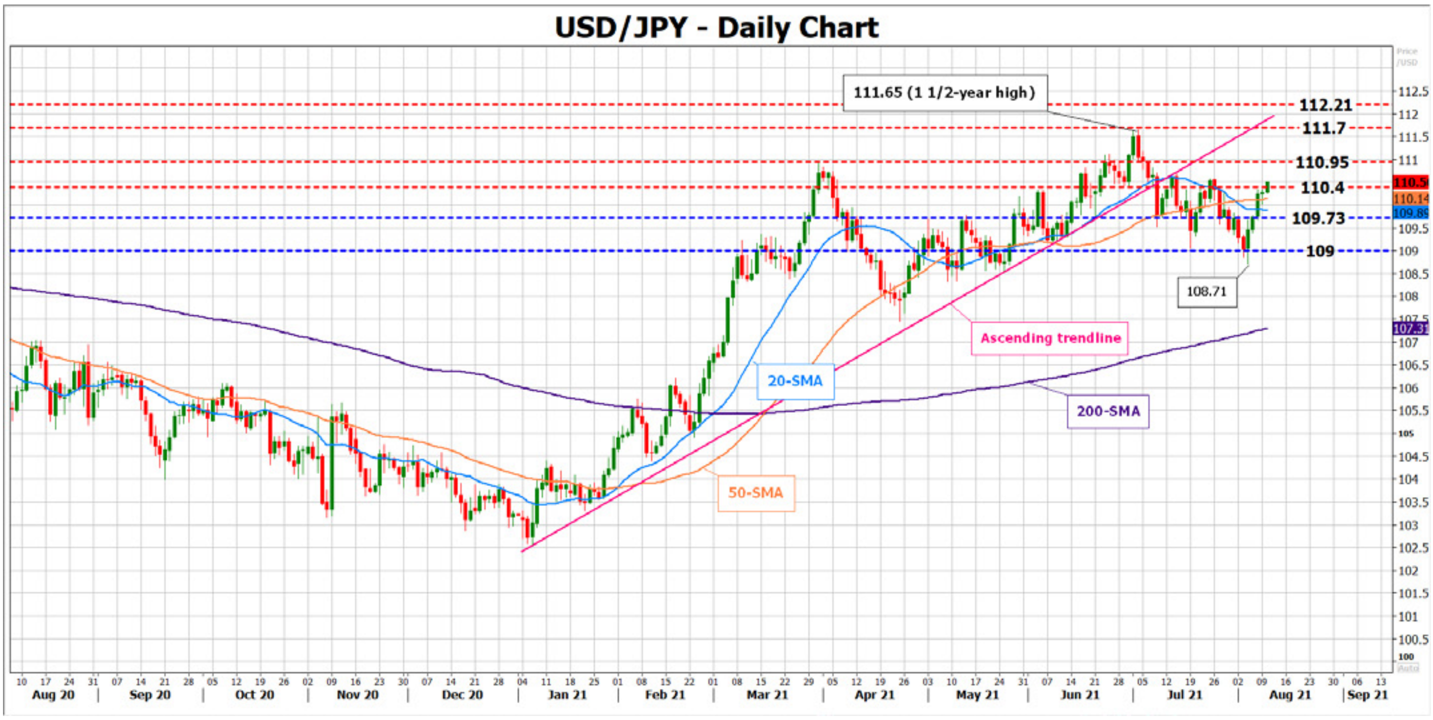
CPI inflation to lose steam in July

On Wednesday, though, CPI stats for the month of July are expected to rise at a softer pace. The headline CPI is forecast to gear marginally down to 5.3% y/y from 5.4% previously, while the core measure, which excludes volatile items such as food and energy, is projected to slip to 4.3% y/y from 4.5%. The monthly change is expected to slow down at a faster pace, falling from 0.9% to 0.5%.



The Bank of England took another step towards normalization this week. The first rate increase is now expected in late 2022, and policyma The above projections suggest a minimal pullback, which could still leave price indices elevated comfortably above 2.0%. Hence, such a result would not affect the dollar much. Probably, a sharper-than-expected slowdown could defend the Fed's transitory explanation and vindicate the falling inflation expectations, reducing the need for a tighter monetary policy, and consequently sending dollar/yen back to the nearby 109.73 support area. Lower, the door would open for the 109.00 mark.

Alternatively, if CPI numbers run surprisingly beyond forecasts, extending their uptrend above 2.0% for the fifth consecutive month, calls for monetary tightening could step up within the Bank, but given the Fed's overall calm tone, any upside correction in dollar/yen could be restricted. Should the pair close above 110.40, the next obstacle could emerge near 110.95 and then around 111.70.



Technical Analysis – USDCAD capped by 200-day SMA; signals mixed

USDCAD bulls got trapped below the 200-day simple moving average (SMA) at 1.2565 after setting a foothold near the 1.2440 level at the end of July.

Short-term signals are mixed at the moment as the latest series of higher highs and higher lows in the RSI and the positive momentum in the Stochastics contrast the slow movement in the MACD, which remains stuck below its red signal line, and the recent bearish cross within the Tenkan-sen and Kijun-sen lines.

As regards the market trend, a bullish intersection between the 20- and 200-day SMAs could add credence to the ongoing short-term uptrend if completed.

Beyond the 200-day SMA, buyers could wisely wait for a close above the 1.2600 level and the broken ascending trendline seen at 1.2635 before raising exposure towards the 1.2738 resistance region. Then, a step above the previous peak of 1.2800 may take a rest near the 1.2880 barrier.

Failure to cross above the 200-day SMA would shift the spotlight back to the 1.2440 floor and the 50-day SMA at 1.2397. A steeper decline may face limitations near the 1.2270 former support area, while slightly lower, the 1.2200 psychological mark could be the next pivot point.

In brief, USDCAD is facing symmetric risks in the short-term picture as the 200-day SMA is blocking the way higher. A move above 1.2635 could confirm a bullish bias, while a drop below 1.2440 could trigger the next bearish phase.

Technical Analysis – USDCHF in a strong bullish run; next target at 0.9231

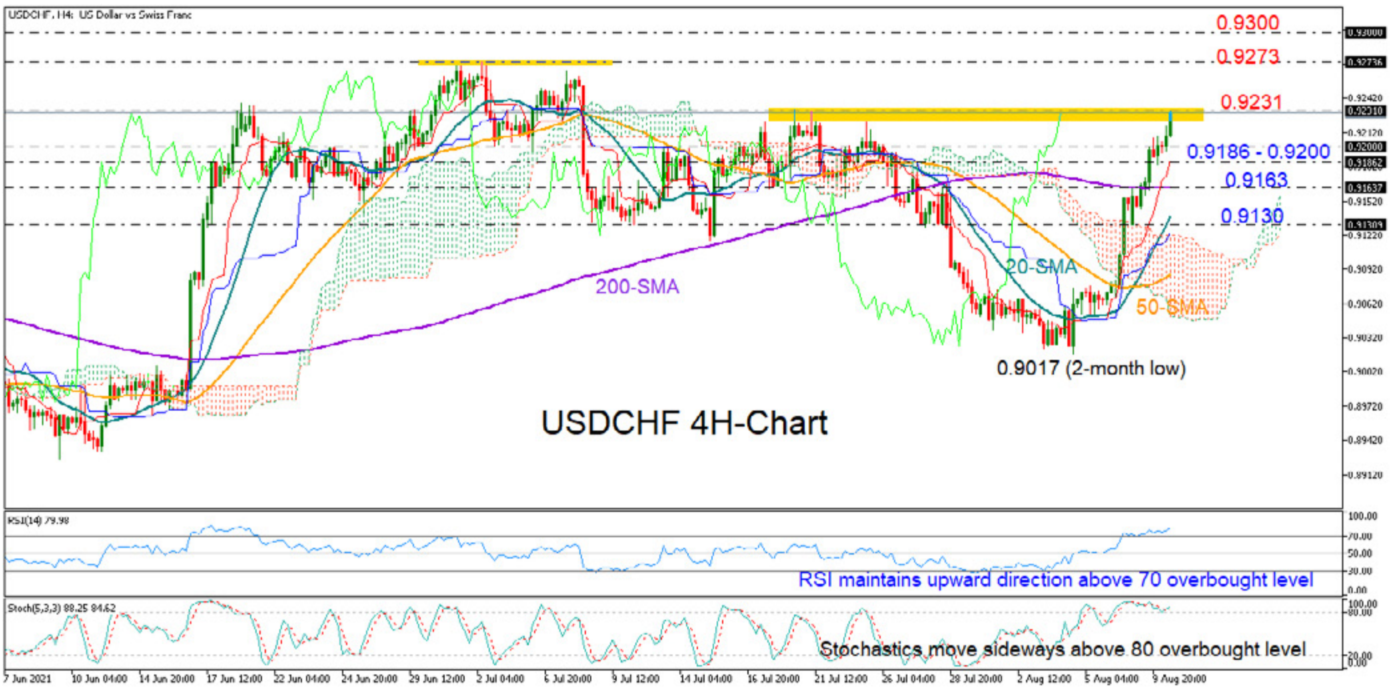
USDCHF advanced by around 1.7% over the past three trading days, quickly crawling above its simple moving averages (SMAs) on the four-hour chart to top at 0.9230 today.

The tough barrier from July 20 is in the neighborhood. Hence, a downside correction around 0.9230 would not be surprising, especially as the RSI and the Stochastics fluctuate above their overbought levels, warning that the recent rally could be overdone. That said, the indicators would need to show a clear shift to the downside to confirm overbought conditions.

If the price accelerates beyond 0.9230, all the attention will turn to July's peak of 0.9273. A break higher would upgrade the outlook in the big picture, though some consolidation could immediately start around the 0.9300 psychological mark before the bulls continue towards the 0.9375 resistance region, last seen during the March-April period.

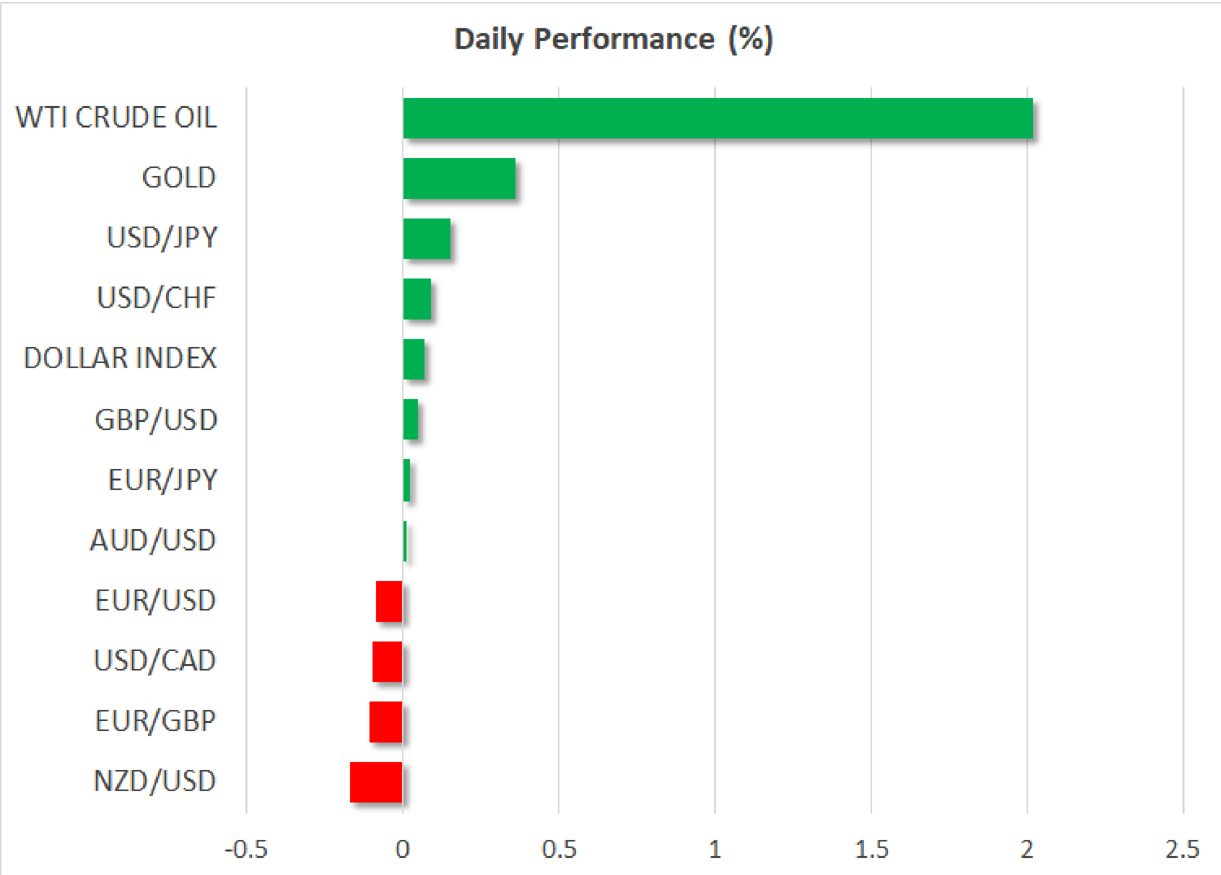
Otherwise, if the bears take control near 0.9230, the price could slide to seek support somewhere between the 0.9200 handle and the protective red Tenkan-sen line currently at 0.9186. Moving lower, the flattening 200-period SMA could next come to the rescue around 0.9163, canceling any declines towards the 20-period SMA and the 0.9130 number.

In brief, USDCHF is viewed as cautiously bullish in the short-term picture. Unless the nearby barrier of 0.9231 blocks the way higher, buying pressures could advance up to 0.9273.



Fed taper talk approaching fever pitch, dollar edges up again

- **Fed officials heighten taper speculation, flag a decision is nearing; dollar stands tall**
- **Optimism keeps stocks afloat even as yields rise, Delta concerns linger**
- **Commodities on steadier footing but Fed tapering, demand uncertainty still weigh**



Fed leaves little doubt tapering is coming soon

The first response by Fed policymakers to last week's stellar jobs report left investors in no doubt that the US central bank is closing in on its criteria of achieving "substantial further progress" towards its goals. The presidents of the Atlanta Fed Raphael Bostic and the Boston Fed Eric Rosengren both hinted that the Fed could announce it will start tapering its $120 billion in monthly asset purchases as early as September. Richmond Fed President Tom Barkin seemed to think inflation is now sustainably back at 2% but was less certain about how much progress has been made towards the Fed's employment goal.

Their comments could be paving the way for a more formal communication at this year's Jackson Hole symposium due to take place at the end of the month. However, it's likely that policymakers will want to wait for at least one more strong NFP print before deciding anything so investors might be kept in the dark through summer.

Yesterday's better-than-expected numbers on job openings, which set a new record high in June, underscored the view that the US labour market is well and truly on the mend. However, policymakers have yet to reach a consensus on how progress in the jobs market should be measured.

Nevertheless, all the indications are that the Fed will begin to withdraw some of its stimulus later this year, whether that's in September, November or December, and the moves in the bond market reflect the growing expectations of a taper announcement at one of those meetings.

Dollar on a roll as yields climb

Treasury yields spiked up again on Monday following the fresh Fed remarks, extending the rebound from last week's lows. The 10-year yield is now back above 1.30%, recovering sharply from a 6-month low of 1.1270% and significantly boosting the US dollar.

The dollar index was flirting with the 93 level on Tuesday for the first time since July 23 before the latest selloff took hold. The euro appears to be the worst hit from the greenback's resurgence, tumbling to a fresh 4-month low of $1.1724 today. The ECB's recently reinforced dovish stance is weighing heavily on the euro, not just against the dollar but against all the majors.

The pound brushed a 17-month high versus the euro on Monday and was edging marginally higher against the dollar today. The loonie was also slightly firmer as oil prices stabilized somewhat along with other commodities. This helped the Australian dollar too, which was flat, offsetting a large drop in business confidence in July according to a NAB survey.

However, the New Zealand dollar remained unusually weak even though the RBNZ is widely expected to hike interest rates next week.

Commodity selloff eases, for now

Metal prices such as copper bounced off their lows to head higher on Tuesday and oil prices were sharply up too. WTI futures jumped 2% to test the $68.00/barrel level, while Brent futures climbed back above $70/barrel.

However, gold was struggling to hold onto earlier gains and was last hovering around $1,730/oz to stand barely up on the day. With the end of ultra-loose monetary policy now in sight in some countries, the non-yielding bullion is not as appealing as it was at the height of the pandemic. And although the Covid threat is far from over and the Delta variant continues to spark panic, most recently in China, there doesn't seem to be much safe-haven flow coming in gold's way.

Stocks maintain positive tone

In equities, European stocks followed Asian markets higher, though US futures were lacking direction. Overall, the reaction on Wall Street to the latest taper signals has been surprisingly benign.

The exceptional earnings season could be bolstering US shares even as the Fed moves closer to removing some of the cheap money, while expectations that the Senate will approve a $1 trillion infrastructure package in a vote due later today could also be shoring up sentiment.

If the bill goes through, the Democrats plan to follow it up with a $3.5 trillion spending plan so perhaps this new fiscal boost, which at one point was looking very uncertain, is easing the pain from the soon-to-be reduced monetary stimulus.

GMT	COUNTRY	INDICATOR	PERIOD	UNIT	ACTUAL	REUTERS POLL	PRIOR
22:45	New Zealand	Elec Card Retail Sale MM	Jul 2021	Percent	0.6		0.9
22:45	New Zealand	Elec Card Retail Sale YY	Jul 2021	Percent	4.7		4
23:50	Japan	Current Account NSA JPY	Jun 2021	JPY	905.1	779.8	1979.7
9:00	Germany	ZEW Economic Sentiment	Aug 2021	Balance		56.7	63.3
9:00	Germany	ZEW Current Conditions	Aug 2021	Index		30	21.9
12:30	United States	Labor Costs Prelim	Q2 2021	Percent		1.1	1.7
12:30	United States	Productivity Prelim	Q2 2021	Percent		3.5	5.4

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