Authors

Simon Harvey
Senior FX Market Analyst
+44 (0)203 650 6472
Simon.Harvey@monexcanada.com

Ima Sammani
FX Market Analyst
+31 (0)20 808 3644
Ima.Sammani@monexcanada.com

Inflation to sit top of mind next week

FX markets have been unsettled this week, with the dollar index swinging around due to choppiness in fixed income and equity markets. On a broader macro scale, price action has been indecisive and lacked clear direction, and this filtered into FX markets. Towards the end of the week, however, negotiations between President Xi and Biden helped to support risk appetite and provide a clearer backdrop for markets, while a swathe of central bank decisions gave further clarity on the path of future policy. Firstly, the Reserve Bank of Australia committed to its decision to taper its QE programme by A$1bn despite the near-term risks to the growth outlook. While in North America, the Bank of Canada maintained its optimistic outlook on the economic recovery despite the brewing fourth wave, and subsequent testimony by Governor Macklem on Thursday provided guidance on what the future of BoC policy looked like once the QE programme was wound down. Then, the ECB stepped up and reduced the pace of PEPP purchases to a "moderately slower" rate, but their inflation forecasts stopped markets taking this message in too hawkish a manner. The National Bank of Poland then held its policy rate at 0.1% despite a 20-year high in the inflation rate, while the Central Bank of Russia hiked rates by a further 25bps, but this failed to live up to the market's expectations.

Calendar

Monday – 13/09

New Zealand's preliminary ANZ activity outlook for September, which tracks the general state of the economy**, is released at 02:00 BST.** New Zealand went into a two-week long national lockdown halfway through August due to a single Covid case, and while most restrictions have now been lifted, Auckland remains in level 4 lockdown for longer.

> "The latest Covid developments are likely to have impacted the activity outlook, but downside risks to the **kiwi dollar** are likely to be limited as this has been priced in by markets and the activity outlook is set to decline from levels above the pre-pandemic average."

At 08:00 BST, Turkey's current account balance for July is released, and any downside lira pressure following the release should be fairly muted given that Trade Minister Mehmut Muş stressed plans to ensure a lower current account deficit in the months ahead despite the reduced tourism revenue. Turkey's goal remains to reach a current account surplus, and the growth in the services exports and tourism revenues in the coming year make this a feasible plan.

For this month's reading, the balance is set to improve further given the rising exports and partial recovery in tourism revenues compared to last year.

Tuesday – 14/09

On Tuesday, **Australia's NAB business conditions for August is on the agenda for 02:30 BST**. Business confidence is unlikely to peak above the zero mark this time around given the deterioration in Covid conditions over the Summer, while the overall conditions index has potential to drop further. **The Reserve Bank of Australia's Philip Lowe speaks in Sydney at 03:45 BST**, which could provide markets with more cues on the economic outlook. **At 07:00 BST, focus turns to UK labour market data from August.** This is the second-last month which still includes furlough payouts, meaning the labour market data won't show the true state of the recovery yet, as this won't be visible until the next quarter. **Spain and Sweden's August CPI are then released at 08:00 and 08:30 BST followed by US CPI at 13:30 BST** (see page 3 for commentary on next week's main CPI releases).

Wednesday – 15/09

> **Westpac consumer confidence for September will be released at 01:30 BST** and is undoubtedly going to be impacted by the recent Covid developments.

Despite daily case counts lingering near record levels, NSW authorities on Thursday said Sydney's businesses could reopen once 70% of the state's adult population is fully vaccinated, a target due to be reached around the middle of October. At the moment, around 44% of the adult population is fully vaccinated. **China's retail sales are then released at 03:00 BST** and are likely to show the recovery faced robust headwinds as the recent outbreaks in the city of Nanjing likely took a toll on retail sales. Virus restrictions were looser in the second half of the month, but with the first two weeks still having a stringent impact this leaves little room for a strong rebound in sales. **UK CPI is released at 07:00 BST while Canada's CPI comes in at 13:30 BST**. **Later at 23:45 BST, New Zealand comes out of the block with its Q2 GDP numbers**, and strong consumer spending and manufacturing data points to a robust Q2 recovery although the nationwide lockdown is expected to derail GDP growth in Q3. Any upside surprises in Q2 GDP could have a smaller impact for the kiwi dollar given the context of the recent nationwide lockdown and current Auckland lockdown.

Thursday – 16/09

Japan's trade balance from August is scheduled for 00:50 BST. The consensus foresees an expansion in August to reach a surplus of ¥138.1bn, largely driven by stronger exports over the course of the month as shipments rose strongly. **At 02:30 BST, Australian labour market data is set to show a contraction in employment from -80K to -115K** as disruptions from Australia's Covid curbs have likely impacted jobs and hours worked, resulting in a higher unemployment rate in August.

Lockdowns in Sydney and Melbourne will likely push down hours worked, while school closures over the summer may have pulled workers from the workforce as well, resulting in a higher unemployment rate. **At 10:00 BST, the eurozone trade balance is expected to rise further to 15.0bn vs 12.4bn previously,** with exports to the UK having risen since the last quarter. **Poland's core CPI data for August comes in at 13:00 BST** after July's reading printed at a 20-year high, and comes in just a week after the National Bank of Poland decided to keep policy unchanged despite the inflationary pressures. Risks to the zloty, should this CPI release print to the upside, are therefore plentiful. **At 13:30 BST, markets turn to US retail sales for August.** July's reading saw retail sales fall slightly, primarily due to weaker auto sales, but this had no significant impact on the trading course of the dollar given that monetary policy expectations were prioritised by markets and retail sales remained above pre-pandemic levels.

> **US retail sales**
> The consensus foresees a continued drop in retail sales, although at a slower pace than in July.

Friday – 17/09

Friday's session begins with **UK retail sales for August at 07:00 BST.** Investors will be heavily scrutinising the data as real time measures strike conflicting messages for the level of consumption. However, with the BoE expecting households to draw down at least part of their lockdown savings, a slip in consumption data is likely to weigh on the pound. **For Turkey, the 12m inflation expectations for September at 08:00 BST** will be crucial for lira traders as they look for ways to gauge the CBRT's reaction function given the high inflation prints over the last couple months and President Erdogan's wish to cut interest rates despite the heightened inflationary pressures. **Finally, Polish employment data for August will be on the agenda at 09:00 BST.** Polish employers are still hiring and have also learnt to adapt to the pandemic business environment, according to the Polish newspaper PAP who spoke with employment industry experts. Employment levels are set to remain unchanged on a month-on-month basis.

Inflation

Next week's data calendar focuses heavily on inflation data in major developed market economies, while core CPI readings from Poland and inflation expectations data in Turkey will be viewed amid historically high CPI readings. The prolonged nature of high inflation readings raises the question as to how transitory the fast pace of price growth is set to be as policymakers across the globe begin to show increasing sensitivity to CPI data. Lately, this increased sensitivity has been the most notable within the eurozone as Northern European ECB members called for tighter monetary policy shortly after inflation rose to 3%. The combination of higher inflation data and a better near-term growth outlook resulted in the ECB announcing a light moderation in its PEPP purchases. However, despite central banks becoming incrementally more hawkish to inflation developments, elevated price pressure continues to divide policymakers. The difference in views between G10 and EM central banks is the most stark. Within the G10, concerns over above-target inflation requires a positive outlook on the economic recovery and labour market to result in a material policy tweak.

Even then, monetary tightening has only taken place via QE to date. However, within the EM space, rising CPI is generally accompanied by increasing nominal interest rates despite the economic backdrop in some countries remaining weak. But even within the EM space, rising inflation is separating the hawks from the doves.

"With high inflation numbers sustained over the past few months, **next week's CPI data will come back into focus for financial markets** as global monetary policy begins to normalise."

Not only will the headline figures be in focus, but also the underlying dynamics as markets look to assess whether the above-target readings are set to be transitory or not. Given the importance of inflation dynamics going forward, we take a closer look at next week's releases below.

US CPI

Headline inflation, as measured by the consumer price index, has risen and tracked above the Fed's average 2% target since March of this year. In response to the rise in inflation, the Federal Reserve has acknowledged that their inflation conditions for normalising policy have been met but continue to emphasise that the overshoot up to levels above 5% is transitory in nature. By doing so, the Fed has now anchored the path of their policy normalisation to the labour market recovery, but there will be a point when markets become concerned with US price growth once again. This will occur either because the labour market recovery is on track to meet the Fed's forecasts, or inflation forces prove to be more durable than the Fed initially expected.

"With progress in the labour market slow going, as evidenced by August's Nonfarm Payrolls data, a more durable overshoot in price growth is likely to be the dynamic that thrusts CPI & PCE data back into the limelight."

Currently, both market and survey based inflation expectations are well anchored around the Fed's inflation framework. However, should underlying forces suggest a more prolonged inflationary environment, US yields are likely to driven higher by breakevens and calls for faster Fed normalisation will become louder. This is unlikely to happen before 2022, but markets could get a good gauge on the persistence of CPI in August's data.

Core inflation is expected to remain hot due to temporary shortages and reopening rebounds, leaving the index to track around 4.2-4.3% in August, but these tailwinds are expected to moderate.

Any signs that core-CPI isn't set to moderate in the coming months after August's elevated print may set the stage for greater inflation concerns.

UK CPI

Similar to the Federal Reserve, the Bank of England has chosen to look through the recent rise in inflation, while concerns over a sustained overshoot are less prominent following the decline in core CPI in July. With the economy yet to recover to pre-pandemic levels, slack in the labour market and a negative output gap, inflation is set to moderate further over the medium-term, but risks in the near-term remain high. Despite the elevated unemployment rate, underlying labour market metrics imply that the level of slack is overstated by the headline figure. Rising wages may filter through to keep price growth at higher levels, while in the near-term, survey measures suggest upwards price pressures due to reopening effects and energy prices.

Canada CPI

Inflation in Canada is expected to remain above 3% at next week's reading, but with headline CPI sitting at 3.7%, a slight period of disinflation is needed for the BoC's forecast of 3.5% CPI YoY in Q4 to be correct. Inflation at present doesn't concern the Bank of Canada, however, with the central bank set to enter the reinvestment phase with their QE programme next year, the progression of inflation will be key for determining the timing of the H2 2022 rate hike.

Further signs that disinflation is yet to occur in August's data may embolden calls for an October taper and rate hikes earlier than H2 2022.

Poland core CPI

Similar to the central banks previously mentioned, the National Bank of Poland is choosing to look through the latest inflation spike and focus on the progression of the growth recovery. However, unlike the Fed, the Bank of England, and the Bank of Canada, the NBP is the only central bank within its geographic region that is not responding to rising inflation with tighter monetary policy. Speaking after the latest NBP meeting on Wednesday and in response to August's 5.4% CPI print, Governor Glapinski stated that "it's central banking 101 that the reaction to negative supply shocks shouldn't be rate increases". While the NBP has kept its dovish tone, a further rise in headline and core CPI will likely result in the central bank upgrading its inflation forecasts in November's projections, which are crucial for future NBP policy according to Glapinski himself.

Turkey inflation expectations

Unlike the aforementioned central banks, the Central Bank of the Republic of Turkey finds itself with a unique dilemma of rising inflation. The spike in headline CPI to 19.25%, above the CBRT's 19% policy rate, resulted in Governor Kavcıoğlu announcing that core CPI is now the measure of choice. With inflation trending in the opposite direction to where the central bank projected it to, inflation expectations may begin to rise again, putting further pressure on headline CPI. Given that the CBRT is expected to disappoint investors at its meeting on September 23rd by holding rates and reneging on its promise to keep real rates positive, a rise in inflation expectations from the current rate of 12.48% could result in an even larger market reaction to the announcement.

Disclaimer

This information has been prepared by Monex Canada Inc., an execution-only service provider. The material is for general information purposes only, and does not take into account your personal circumstances or objectives. Nothing in this material is, or should be considered to be, financial, investment or other advice on which reliance should be placed. No representation or warranty is given as to the accuracy or completeness of this information. No opinion given in the material constitutes a recommendation by Monex Canada Inc., or the author that any particular transaction or investment strategy is suitable for any specific person. The material has not been prepared in accordance with legal requirements designed to promote the independence of investment research, it is not subject to any prohibition on dealing ahead of the dissemination of investment research and as such is considered to be a marketing communication.