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Central bank bonanza

Market concerns around an energy supply crunch in Europe intensified over the week as the disruptions sent European energy prices to the roof and occupied headlines throughout the week. On the back of this, EURUSD dropped down to lows last seen in August, while a stronger dollar across the board also weighed on the pair. On the USD side, global growth concerns due to the Delta variant, along with poor data from China led to the greenback being bid across the G10, while US retail sales took the rally a step further when they surprised to the upside. Next week's calendar is packed with central bank meetings, with the FOMC's decision on Wednesday eyed as the most important economic event by markets as the decision comes with a fresh dot plot. On top of that, the Bank of England is set to release their latest policy decision, while the Norges Bank is expected to be the first G10 central bank to raise rates since the pandemic. Markets will also tune into meetings from the Bank of Japan, the Riksbank, the central bank of Brazil and the CBRT.

Calendar

Monday – 20/09

Monday's data docket is quite sparse with markets predominantly eying the **weekly asset purchase data published by the European Central Bank at 14:45 BST** as the data includes the first week of purchases after the ECB's decision to moderately slow down bond-buying via the Pandemic Emergency Purchase Programme (PEPP). Redemption data is not included in the release, as this is published the day after. We advise caution when looking at this data as weekly purchases tend to be quite noisey. However, the data will still be viewed by markets as they try to quantify the monthly purchase pace that is attributed to the "moderately slower".

Tuesday – 21/09

The Riksbank will announce its policy decision at 08:30 BST. The decision comes after a significant inflation shock in August, which may see the dovish central bank's communication shift more hawkish. The CPIF, the Riksbank's target measure, rose to 2.4% in August to stand a whole percentage point above the Riksbank's forecast of 1.4%. Up until now, the Riksbank, just like many other central banks, shrugged off the recent acceleration in inflation as temporary, but the market reaction in SEK shows traders think otherwise. September's meeting is unlikely to include any actual changes in policy, however there will likely be a large revision to the central bank's inflation and growth forecasts, which increases the risk of a lifted rate path further down the road. The Riksbank's current rate path indicates the policy rate will be kept on hold until the third quarter of 2024, at least.

Wednesday – 22/09

South African CPI will be released at 09:00 BST on Wednesday and could result in the South African Reserve Bank casting a more dovish tone in Thursday's meeting should headline CPI moderate back towards the 4.5% target midpoint. Back in July, inflation dropped to the lowest level in three months, cooling rate hike bets. Expectations are for the headline reading to rise from 4.6% to 4.9% in August. **Russian industrial production growth is on the agenda for 17:00 BST** and is set to show a slight moderation on an annual basis after last month's print decelerated to a lower-than-expected 6.8% in July.

> **The Fed's latest policy decision at 19:00 BST** is the stand-out economic event next week.

While we don't expect the Fed to announce the beginning of its QE tapering in September, which has been a long-held view that was compounded by August's payrolls, the latest Summary of Economic Projections will be key for market pricing. Alongside the Fed's GDP and inflation projections are their interest rate projections, which could see Fed officials form a consensus around a 2022 hike, while the latest dot plot will also include 2024 projections for the first time. Only 2 FOMC members would need to shift their views from holding rates in 2022 to favour a 25bps hike for the median consensus to shift upwards, which would support higher front-end yields and the dollar.

The focus won't just be on the median lift-off projection though. The inclusion of 2024 interest rate projections also means markets will get a clearer view of how steep the Fed's hiking cycle is expected to be given their economic projections, which could play out in the belly of the curve. Hawkish messaging from Fed officials via the dot plot is likely to support the dollar in the initial aftermath, however, it must be noted that Chair Powell dampened the hawkish tone the last time the Fed updated their dot plot - this dynamic could play out again. Over the medium-term, we don't expect a marginally more hawkish dot plot to change our structurally bearish view on the US dollar, however, our expectation of cyclical downside in the greenback could be moderated should Fed officials substantially raise their implied rate path.

At 22:00 BST, the Central Bank of Brazil (BCB) announces its new Selic rate which is expected to include a firm rate hike to prevent inflation from getting out of control. Expectations are for the rate to increase by a percentage point from 5.25% to 6.25%, which may lead to a brief rally in the real if delivered correctly. In August, however, gains after the 100bp rate hike were short-lived as concerns around the country's fiscal situation were more prevalent. **The Bank of Japan announces its policy decision on Wednesday as well,** although the timing as always remains unknown. The Bank is set to maintain its view on current overall economic conditions, although its assessment of consumption may be lowered moderately given recent developments in services spending following the extended state of emergency. The maintained view should be reflected in unchanged policy parameters, including policy rates, asset purchase guidelines and forward guidance. For this reason, any JPY action is likely to remain muted, although any confirmation of concerns around the Delta variant in Southeast Asian countries could support the currency due to haven flow.

Thursday – 23/09

Australia's preliminary September PMIs kick start the day at 00:00 BST. After contracting in July and August due to tighter lockdown measures, the composite PMI is likely to print even lower than last month's 43.3 reading as services activity feels the pinch from sustained lockdown measures. Sticking with the PMI trend, **eurozone PMIs are released between 08:15 and 09:00 BST** with French PMIs at 08:15 starting proceedings. Both manufacturing and services PMIs are expected to moderate further, owing to the maturing nature of the recovery. A similar theme is expected in Germany, with the composite PMI expected to fall from 60 to 59.5. The eurozone-wide measure, released at 09:00, should see the composite fall from 59 to 58.7 if expectations are to be met. **At 09:00 BST, the Norges Bank will then release their latest policy decision** with expectations set for them to be the first G10 central bank to hike rates post-pandemic. Both markets and economists expect a 25bp rate hike on Thursday, with accompanying guidance set to confirm another hike in December. With the September hike being fully priced in, the NOK reaction is unlikely to go much beyond a brief relief rally. Should the NB's tone make markets doubt if December will be the time for a second hike, this will weigh on the krone.

Just before the BoE takes centre stage, **UK preliminary PMIs for September are released at 09:30 BST.** Similar to other nations, the composite PMI is set to moderate, with the decline driven by slowing activity in the services sector. **The Bank of England is then set to release its latest policy at 12:00 BST** but with no monetary policy report or press conference, it is unlikely to be a big event for markets, especially given expectations of an 8-1 vote in favour of keeping the QE programme in its current form. The meeting minutes will be the area investors and economists focus on the most, especially given Governor Bailey's comments recently that half of the members now view the minimum conditions for policy normalisation as being largely met. The minutes are likely to update markets on any changes to this view, especially given the arrival of Huw Pill as Chief Economist and Catherine Mann as a replacement to Gertjan Vlieghe. **Released alongside the BoE is Turkey's latest policy rate.** With inflation rising above 19% to print at 19.25% in August, the CBRT soon had to change their messaging from keeping real rates positive to viewing core inflation as the most representative inflation metric. The CBRT looks to be balancing the political pressure to lower rates alongside the market's distaste for the decline in real carry, however, Thursday's meeting looks set to be the crunch point. Should the central bank continue to renege on its commitment to keep real rates positive, or even cut rates due to its focus on the core measure, the market reaction is likely to be large for the lira. On the other hand, any commitment to raising rates may also provide limited relief for TRY, as the prospect of political intervention in monetary policy increases.

Following the central banks at midday is **Canadian retail sales data for July at 13:30 BST.** While US retail sales data for August resulted in a large USD bid, Canada's data is unlikely to provide much of a market reaction.

"Retail sales are expected to rise in July due to reopening effects, but the data is too lagged to give markets a read on how consumption has held up under Delta concerns of late. Released alongside the Canadian data is **US jobless claims numbers** for the week ending September 17th."

As the insurance top-up begins to fade, the initial claims data should continue to moderate, but the data itself doesn't hold much of a market impact unless the figures show a dramatic improvement in labour market conditions. **September's preliminary US PMIs are then released at 14:45 BST** and are likely to show the recovery moderating in pace ever so slightly. The activity data will be viewed against the Fed's latest GDP projections, which are released on Wednesday. At some point throughout the day, the **South Africa Reserve Bank** is set to update markets with their latest policy. The SARB is expected to keep rates on hold at 3.5%, but should inflation in August moderate, a more dovish tone may be attached to the decision to hold.

Friday – 24/09

UK GfK consumer confidence is released a minute after midnight and is set to show a mild improvement from August's reading but still print in negative territory at -7. The GfK data hasn't been a huge market-moving release over the last months, but as the recovery progresses the confidence indicators will likely gain importance. **Japan's CPI is then scheduled for release at 00:30 BST**. The national core CPI, which excludes fresh food, is expected to accelerate to 0.0% YoY in August up from -0.2% in July, while the headline YoY reading is set to remain unchanged at -0.3%. **Swedish PPI is then released at 08:30 BST** after both the July and August readings included significant expansions as price pressures intensified over the summer.

> "**The German Ifo survey at 09:00 BST will provide clues on the domestic recovery prospects** after August's expectations index fell to 97.5 from 101 previously."

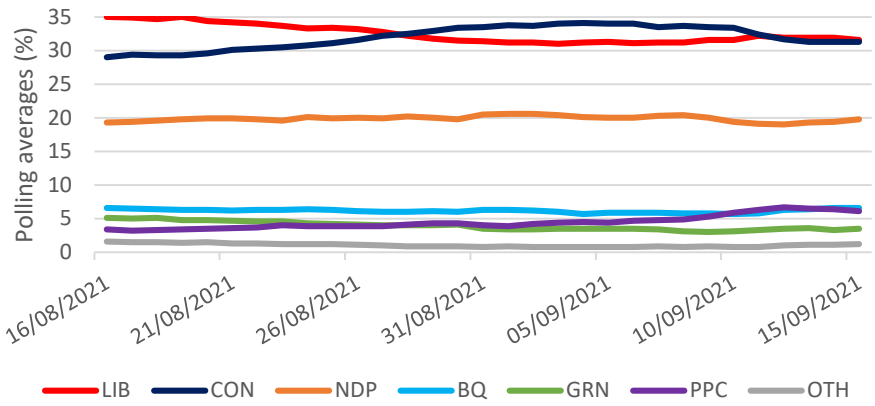
The expectations index is set to remain broadly unchanged this time around, with the consensus foreseeing a reading of 97.0, while the current assessment index is expected to grow to 102 down from 101.4 in August. **A series of Italian confidence indicators are also released at 09:00 BST**, including consumer, manufacturing and economic confidence.

Canada election preview

A swift result is unlikely, as is a large market reaction

Canada's electorate head to the polls on Monday 20th September, less than two years since the last election in October 2019, after Prime Minister and minority leader Justin Trudeau looked to capitalise on his successful vaccine campaign and secure a parliamentary majority. However, the best-laid plans often go awry. Since calling the election, Trudeau was subject to substantial backlash from opposition party leaders for calling an election while the pandemic persists within the country. This has seen the Liberal Party's polling decline substantially over the past weeks, as voters switched their views to favour the Conservatives, while the New Democrat Party have also picked up some momentum at the margin (chart 1).

Chart 1: The Liberal's polling advantage is slowly eroded as the campaign progressed, with the outcome likely to be close



***Source**: CBC poll tracker*

As things stand, the election is more likely to produce a minority government than not, especially with close polling between the Liberals and Conservatives and the limited divergence in party policies between the two. However, who claims the minority government, or whether a working coalition is formed, is yet to be decided, while uncertainty over the result is only increased by the large polling error and the elevated number of mail-in ballots this year. On the former point, 338 Canada's seat projection sees the Liberal Party winning 144 seats, with the Conservatives winning 128 and the NDP 32. All modal forecasts are below the 170 needed to command a working parliamentary majority; however, for the leading two parties the margin of error sits above 40 seats. Assuming the upper limit of the polling error is reached, this suggests the Liberals could win an overall majority, while the Tories would fall short by 2 votes. However, they place the odds of a Tory majority outcome at just 16%.

> "Adding to the election uncertainty for markets is the likelihood that the final outcome won't be clear on election night."

Similar to the US election in 2020, the health backdrop has resulted in a large number of mail-in ballots - a record 1.2m have been requested. Elections Canada spokesperson Natasha Gauthier said it could take 2-5 days to count mail-in ballots as they are individually verified to avoid double counting with in person voting.

This would increase uncertainty around the outcome after the Election Day itself, especially if the outcome from the in person election remains narrow.

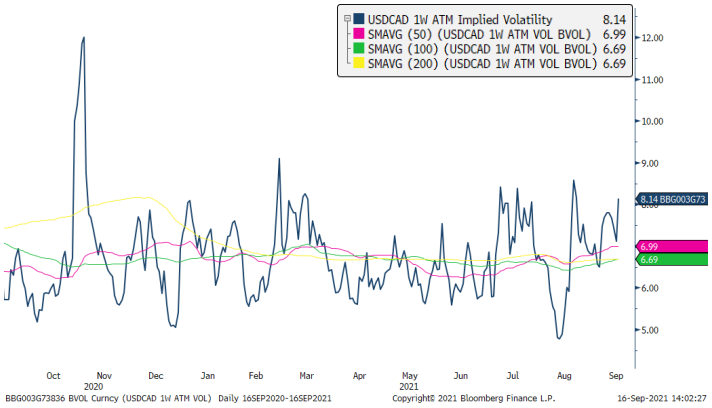
Despite uncertainty around the election outcome, the market reaction is likely to be muted

Regardless of whether the election will yield a majority government or not, the result is unlikely to have a huge market impact. Firstly, net spending plans from both the Conservative and Liberal parties are within C$1bn of each other over the next five years, meaning the net fiscal swing is limited given the election outcome. As well as both parties having similar fiscal trajectories over the 10-year horizon too, spending policies are unlikely to move markets in the event of either party gaining a clear majority.

Actual spending policies do differ, however, but only marginally, while neither leading party addresses key concerns over longer-run growth such as Canada's low productivity growth or ageing population. The Conservative Party's more front-loaded stimulus spending may be viewed as more growth friendly though, purely because it is likely to have a larger fiscal multiplier to its timing.

"The clearest election read comes from a minority government, which is likely to weigh on Canadian assets should a working majority not be feasible between parties. A more stagnant minority government reduces the likelihood of additional fiscal stimulus and weighs on the growth outlook. However, we subjectively place the risk of such an outcome as low, especially given recent polling favours a resumption in the Liberal-NDP working coalition."

Chart 2: One-week USDCAD implied volatility sits above recent averages, but isn't representative of election hedging demand as it also incorporates the September Fed meeting



Market positioning ahead of next week's election results is unclear. While 1-week implied volatility suggests increased hedging demand ahead of the election, the timeframe also includes the Fed's September meeting, which could prove instrumental for FX markets given the meeting includes fresh interest rate projections. Option skew does favour USDCAD calls, however, suggesting markets are wary of a sharp upside move in the pair over the course of the week. Whether this is speculative or due to increased hedging is unclear, but it does suggest that a smooth election outcome and a dovish Fed could result in a strong move in USDCAD towards the downside.

Chart 3: Risk reversals show demand for USDCAD call options dominate put options

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