POWELL SETS JULY RATE CUTS IN STONE

MORNING REPORT: 11TH JULY 2019

USD

The dollar weakened yesterday after Jerome Powell confirmed that the Federal Reserve would almost certainly be cutting rates in the near future. The Fed Chair gave one of the most unambiguously dovish performances from a central bank head in recent memory, outlining the likely justifications for easing in the near future. These included worsening global conditions and political uncertainty weighing on the US economy in the immediate future and a tepid medium-term inflation outlook. For now, the wind seems to have been taken out of the dollar's sails, but the Fed's cuts may not change the picture for USD significantly. Although Powell has laid the groundwork for at least 50bp of cuts in the near future, fixed income pricing of Fed policy is so extreme that there is still plenty of room for an upside surprise if the current bout of uncertainty dissipates and downside inflation risks don't materialise. US Consumer Price Index data will be released today at 13:30 BST, followed by another round of testimony from Powell to Senate lawmakers at 15:00.

GBP

A broad dollar sell-off came to sterling's rescue after it hit lows not seen since 2017 in yesterday's session despite May's GDP reading surprising to the upside at 0.3% QoQ. Bank of England policymaker, Silvana Tenreyro, backed away from the idea of raising interest rates in the coming months, marking the impact Brexit is having on monetary policy as the economy begins to show the effects. "Coupled with signs of a weaker global outlook, recent developments likely lengthen the period until there is a sufficient pickup in inflationary pressures for me to vote to raise rates," she said while stating that loosening policy in the event of a no-deal Brexit is the likeliest option but by no means a foregone conclusion. Today at 10:30 BST the BoE Financial Stability Report is due, directly followed by a press conference of BoE Governor Mark Carney.

EUR

Upside surprises on French and Italian May Industrial Production brought a sigh of relief to the euro, which reached a four-day high against USD after succumbing to USD pressure in the weeks prior. Italian IP rose by 0.9% versus 0.1% expected, while the French figures came in at a soaring +2.1% versus +0.3% expected. These readings defy downbeat business surveys earlier and may paint smug looks on some faces in the streets of Paris and Rome, as this growth is in sharp contrast with the contractionary phase the German Industrial Production is currently going through. As France's industrial sector produces more products destined for Eurozone markets, compared to German's global focus, the narrative that domestic Eurozone demand remains resilient while the global economy slows down, continues to gain traction. Base effects will likely revert the strong French April and May IP readings, but for now, risks to Q2 French growth from this sector definitely point to the upside.

CAD

A little wobble never hurt nobody - is what the loonie may have thought yesterday after it saw a strong bout of intraday volatility around the Bank of Canada and Federal Reserve events before it went for a decisive rally against USD at the end of the day. Yesterday's Bank of Canada Rate Announcement and Press Conference can be summarized as: "So far so good for Governor Poloz", although the road is long and headwinds are plentiful. The Bank of Canada remains in a precarious position. A rebound in domestic economic growth and rising inflationary pressures are offset by a bleak external economic climate and increasingly accommodative monetary stances elsewhere in the G10. Any hints of hawkish undertones would have only stoked fixed income markets and in turn the loonie, leading to an erosion in much of the economic rebound thus far. While markets currently lap up every minuscule of central bank commentary, Poloz's ability to extend the dovish tones from the MPR into the press conference was impressive. By stressing the external risks to the BoC's outlook extensively across both the report and the press conference, both Poloz and Wilkins effectively contained market expectations of a move by the BoC in either direction. For now, the status quo is maintained in what proved to be a predictable BoC meeting due to the number of uncertain dynamics in play. Little more can be extrapolated from yesterday's communications, especially given much of the commentary geared towards the uncertainty of US-Sino relations and the Fed's monetary policy path. What is known, however, is that conditions in Canada's economy are firming, and any alleviation of the external crosswinds will likely force the BoC back into action to control inflationary pressures. With that being said, given our base case for the US-China trade war extending into 2020, our expectations of a rate cut by the BoC are unmoved. We favour a 25bp cut due to the likely slowdown in growth and increasing uncertainty in the global backdrop, with the timing of the cut skewed towards the beginning of 2020.