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19 August 2014

# US and UK CPI: still close to target

The SA Daily

South Africa | FX & FI

## FX

US CPI data will be published today, as well as housing starts and building permits. The CPI is seen rising 0.1% m/m in July, which would take it to a slightly lower 2.0% in y/y terms from 2.1% in June. The core measure is seen climbing 0.2% m/m, leaving the y/y change steady at 1.9%. Steve Barrow, our G10 Strategist, feels that the risks lie on the downside, which could aid treasuries, if he is correct. However, Steve also thinks that housing data could be a bit above the consensus, and this might mean that the two releases offset one another when it comes to the market reaction. Housing starts are seen rising 8.1% m/m in July, after June's -9.3% m/m contraction. Consensus has July building permits growing 2.8% m/m, which would represent a meaningful swing compared with a -4.2% m/m contraction in June.

UK CPI and PPI data for July will also be published today. The CPI is seen falling 0.2% m/m, lowering the annual rate to 1.8% from 1.9% in June. Steve feels that the data will be at least as low as anticipated, and might be lower, as food prices continue to fall, petrol prices decline and summer clothing sales kick in. For the PPI data, he thinks the consensus will prove correct, at least for output prices, which tend to be more stable than input prices. Overall, Steve thinks the message will be that price pressures remain very muted. That might weigh on sterling but, as we know from the BoE's latest remarks, it's wages and not the CPI that's the big focus at the moment. And we also know that the Bank won't necessarily wait until wages rise more sharply before hiking rates. With this in mind, any reaction to today's data could prove fleeting. The main focus in the UK this week will be on the MPC minutes to be released tomorrow.

The rand weakened slightly further against the US dollar yesterday, closing at USDZAR10.60, compared with Friday's close of USDZAR10.59. The rand depreciated into a mixed performance from the dollar against the major crosses, and notwithstanding a mild increase in global risk appetite. Commodity currencies we monitor for purposes of this report were mixed to weaker, while EM currencies were mixed to stronger on the day. The dollar strengthened against the euro and the yen, while weakening against the pound. Three of the five commodity currencies we monitor – namely, the NZD, the ZAR and the NOK – depreciated. The CAD and the AUD both appreciated.

**Key financial market indicators**

| Spot | | chg | Cross Rates | | chg |
|---|---|---|---|---|---|
| USDZAR | 10.60 | 0.11% | EURUSD | 1.34 | -0.28% |
| EURZAR | 14.17 | -0.18% | GBPUSD | 1.67 | 0.21% |
| GBPZAR | 17.74 | 0.31% | USDJPY | 102.57 | 0.21% |
| ZARJPY | 9.67 | 0.08% | AUDUSD | 0.93 | 0.03% |
| **USDZAR fwd** | | **chg** | **Commodities** | | **chg** |
| 1m | 10.66 | 0.14% | Gold | 1298.43 | -0.49% |
| 3m | 10.77 | 0.11% | Platinum | 1444.25 | -0.79% |
| 6m | 10.95 | 0.14% | Copper | 6905.00 | 0.51% |
| 12m | 11.30 | 0.12% | Brent | 101.60 | -1.86% |
| **Equities/Risk** | | **chg** | **US Yields/spreads** | | **chg (pps)** |
| ALSI | 51519 | 0.63% | US 10 yr | 2.40 | 0.05 |
| VIX | 12.32 | -6.31% | US 30 yr | 3.20 | 0.07 |
| MSCI World | 1727 | 0.77% | EMBI | 302.72 | -5.72 |
| MSCI EM | 1077 | 0.24% | SA CDS | 179.84 | -3.63 |
| **Bonds** | | **chg (pps)** | **Rates** | | **chg (pps)** |
| R 203 | 7.07 | 0.02 | 3m JIBAR | 6.08 | 0.00 |
| R 208 | 7.85 | 0.03 | FRA 3x6 | 6.22 | 0.00 |
| R 186 | 8.29 | 0.04 | FRA 6x9 | 6.43 | -0.03 |
| R 214 | 8.97 | 0.02 | FRA 12x15 | 6.78 | -0.03 |

Source: Standard Bank Research, Bloomberg

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Five of the nine EM currencies we monitor appreciated. The exceptions were the IDR, the HUF and the ZAR, all of which depreciated. The INR was unchanged both yesterday and on Friday, as India's markets were closed by virtue of two public holidays (Independence Day on 15 August and Parsi New Year's Day on 18 August). The rand was the second-worst-performing commodity currency (beating only the NOK) and ranked last among its EM peers. The rand traded between a low of USDZAR10.5691 and a high of USDZAR10.6390 yesterday. Support from where the rand opened this morning sits at 10.6000, 10.5250, 10.4850, 10.4560 and 10.4000. Resistance levels sit at 10.6500, 10.7200, 10.7700 and 10.8400.

Turning to commodity prices, Brent, platinum and gold fell by 1.9%, 0.8 and 0.5% respectively. Copper meanwhile rose by 0.5%. The ALSI rose by 0.6% and the EM MSCI edged 0.2% higher on the day. The EMBI spread compressed by 6 bps and the SA CDS 5yr spread compressed by 4 bps. The CBOE VIX index, a volatility proxy for global risk appetite/aversion, fell by 6.3%.

Non-residents were net sellers of local bonds (-ZAR661 million) yesterday. Selling of bonds was seen in the 12+ (-ZAR1 058 million) year bucket. Buying was meanwhile seen in the 7-12 (ZAR250 million), 3-7 (ZAR106 million) and 1-3 (ZAR41 million) year segments. Bond yields rose by between 2 bps (R203 and R214) and 4 bps (R186) on the day. The 6x9 and 12x15 FRAs both fell by 3 bps, while the 3x6 FRA was unchanged.

*By Bruce Donald, Marc Ground and Varushka Singh*

## FI

Turnover remains low, with only ZAR12.7bn traded in nominal bonds. The R186 (33% of turnover), R209 (12%) and R2030 (10%) were the most heavily traded on the day. Bond yields shifted slightly higher, led by moves in the belly of the curve which sold off the most. FRAs, however, went lower. Over the past two weeks, we have seen asset swaps increase across the curve, as swaps have rallied more aggressively than bonds. This has seen the asset swap on the R186 turn positive, after having been negative for over a year. This may be a result of a combination of less pressure on swaps due to the delay in the financial close of round 3 of the renewables deal, as well as the lower liquidity in bonds seeing investors receiving swaps to pick-up carry.

Today's SAGB auction has ZAR1.00bn on offer in the R2032, ZAR850m on offer in the R2037 and ZAR500m in the R2044, replicating last week's auction which received good demand as all three bonds priced more competitively compared with market levels at the time. It could be a slightly quieter auction, with market participants awaiting tomorrow's print for CPI for July (consensus: 6.4% y/y; previous: 6.6% y/y). A higher than consensus print would likely see the curve bear flatten, due to its likely implication for monetary policy. The R2032 and R2044 will both still have the increased 100% non-competitive auction option available. The R2037 will have the standard 50% option available.

Non-residents were net sellers of nominal SAGBs yesterday for a total of -ZAR661m. Foreign selling was concentrated in the 12+ year segment, with -ZAR1.06bn sold in this category. Significant selling in this extended-maturity segment was recorded in the R2030 (-ZAR963m), R186 (-ZAR459m), R213 (-ZAR383m) and R2048 (-ZAR122m); this was partially offset by net buying in the R214 (+ZAR463m) and R2032 (+ZAR308m) in this segment. The only other notable transactions on the day were recorded in the R2023 in the 7-12 year segment, which saw +ZAR250m of foreign buying and in the R204 in the 3-7 year segment, which saw +ZAR153m in foreign buying.

The Financial Services Board is allowing funds to “side-pocket” African Bank debt. This will separate the currently iliquid African Bank debt from the other more liquid debt in the portfolio. This should reduce any portfolio volatility due to the ABIL debt, showing the performance of the rest of the fund.

The US Treasury curve steepened yesterday, as USTs weakened overall. The yield on the 2yr UST rose by the smallest increment, of 0.80 of a bp to 0.42%. The yield on the 5yr UST rose by 3.78 bps to 1.57%, and the 10yr UST rose by 5.30 bps to 2.39%. At the longer-end, the yield on the 30yr note rose by the largest increment, of 6.60 bps, to 3.20%.

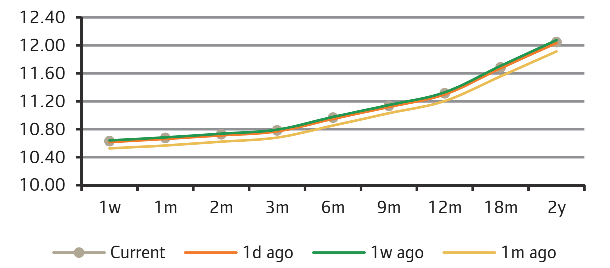
EM FI markets delivered a mixed performance yesterday, as large moves (both weaker and stronger) were recorded across the countries we monitor for the purposes of our reports. This saw 5yr yields rise by an average of 1.24 bps, while 10yr yields fell by an average of 1.23 bps. SA’s FI market weakened on balance, with the 5yr note rising by 1.00 bp (outperforming in this tenor), and the 10yr note rising by 2.30 bps (underperforming in this tenor). Hungary’s FI market moved stronger, relative to the EMs we cover, with the 5yr and 10yr yields declining by 12.00 bps and 13.00 bps respectively. In the 10yr space, Brazil and Poland saw their longer-dated notes decline by 9.90 bps and 7.70 bps respectively. In the 5yr space, the only other EM to record a decline in its shorter-dated note was Poland (-4.10 bps). In contrast, Russia’s FI market recorded the weakest performance yesterday, with the 5yr and 10yr notes rising by 17.35 bps and 14.74 bps respectively. Other individual FI market moves weaker were marginal in comparison.

Weaker Russian bonds were likely on the back of the announcement by the Central Bank of Russia (CBR) that they would widen the trading range for the ruble to 9 from 7 to “further increase the rouble exchange rate flexibility”. The CBR simultaneously announced that they would lessen the use of currency reserves for intervention, “from $1,000 mln. to $350 mln”. This was traditionally used to limit volatility in the day-to-day trading of the Russian ruble. A wider foreign exchange rate trading band with less scope for central bank intervention (as noted by the Bank) is interest rate negative because of the implications that a sustained depreciation in the currency may have on inflation expectations. As the CBR moves towards a policy of inflation targeting, a weaker currency would likely raise the prospects for further interest rate hikes.

The news out of Russia’s central bank saw the ruble appreciate by 0.36%, leading the moves stronger across most of the EM currencies we monitor. This was followed by a 0.23% appreciation in the Polish zloty, a 0.21% appreciation in the Mexican peso and a 0.17% appreciation in the Turkish lira. The Thai bhat (0.13%) and the Brazilian real (0.12%) also appreciated on the day. In contrast, the SA rand depreciated yesterday, by 0.11%. Other EM currencies to depreciate on the day, were the Indonesian rupiah (0.08%) and Hungarian forint (0.09%).

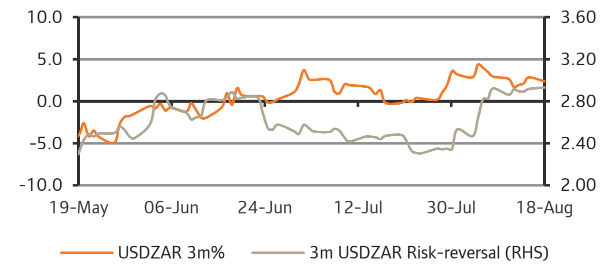
*By Asher Lipson and Kuvasha Naidoo*

### Figure 1: USDZAR forwards



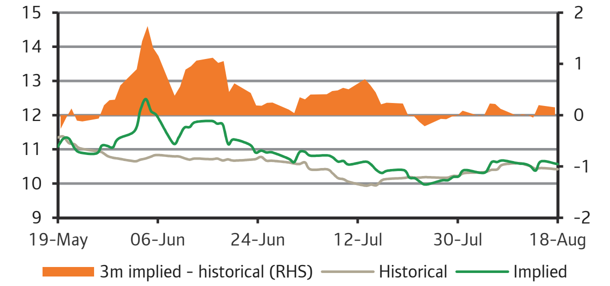

Source: Standard Bank Research, Bloomberg

### Figure 2: USDZAR vs risk-reversal



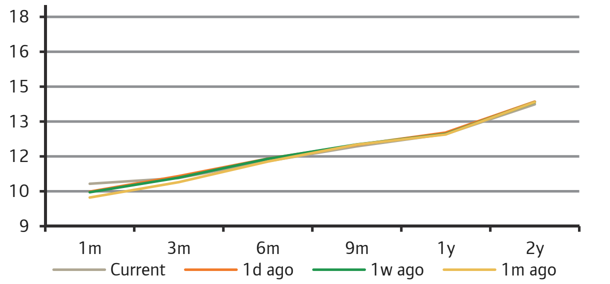

Source: Standard Bank Research, Bloomberg

### Figure 3: Implied vs. actual USDZAR volatility



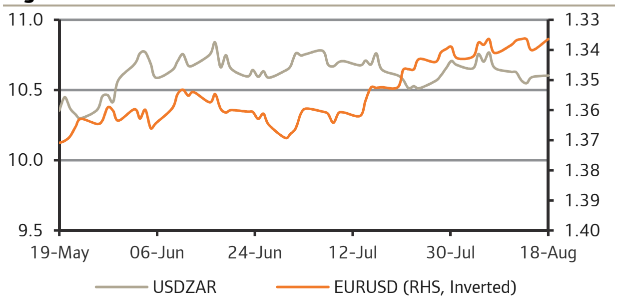

Source: Standard Bank Research, Bloomberg

### Figure 4: USDZAR volatility curves



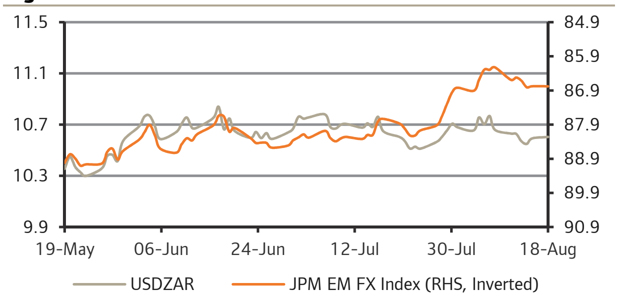

Source: Standard Bank Research, Bloomberg

### Figure 5: USDZAR vs. EURUSD



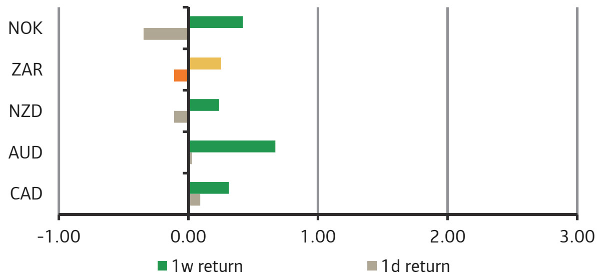

Source: Standard Bank Research, Bloomberg

### Figure 6: USDZAR vs. EM FX index



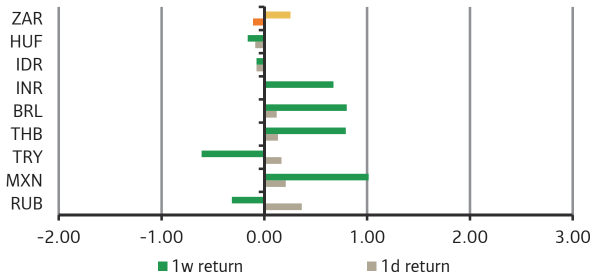

Source: Standard Bank Research, Bloomberg

### Figure 7: USDZAR vs. commodity currency performance



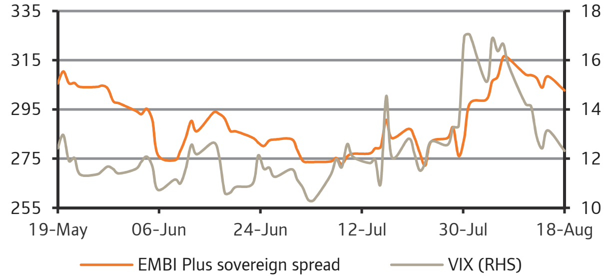

Source: Standard Bank Research, Bloomberg

### Figure 8: USDZAR vs. EM currency performance



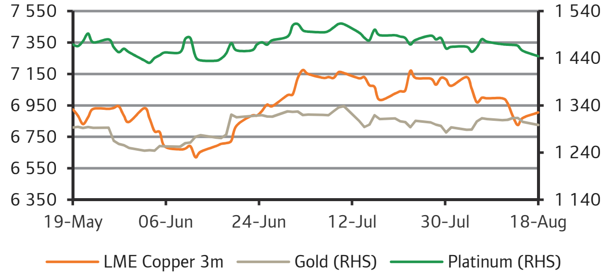

Source: Standard Bank Research, Bloomberg

### Figure 9: VIX global risk appetite proxy vs. EMBI



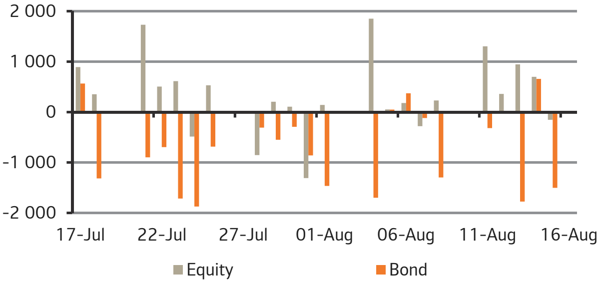

Source: Standard Bank Research, Bloomberg

### Figure 10: Commodity prices



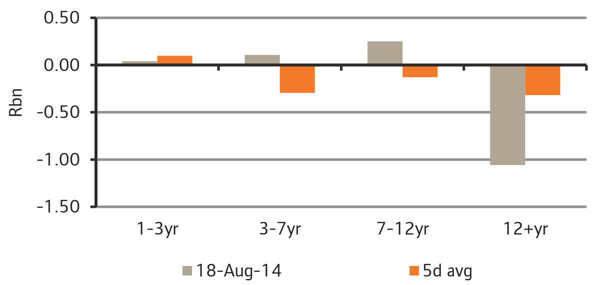

Source: Standard Bank Research, Bloomberg

### Figure 11: Foreign purchases of SA bonds and equities



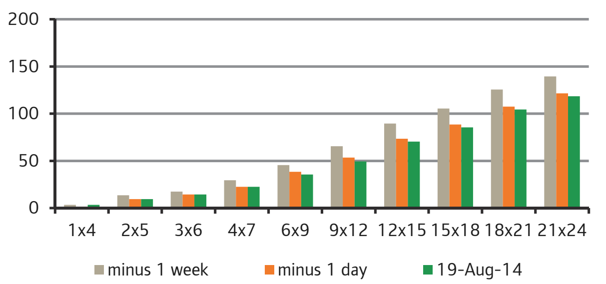

Source: Standard Bank Research, Bloomberg

### Figure 12: Foreign purchases of SA bonds by maturity



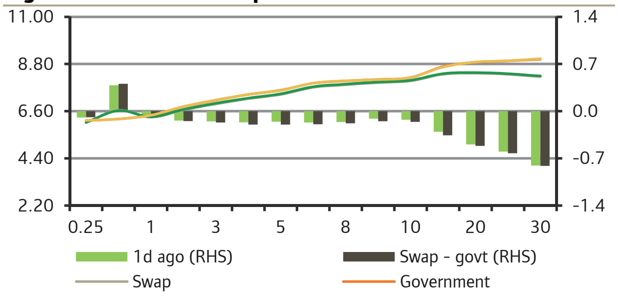

Source: Standard Bank Research, JSE

### Figure 13: FRAs less JIBAR



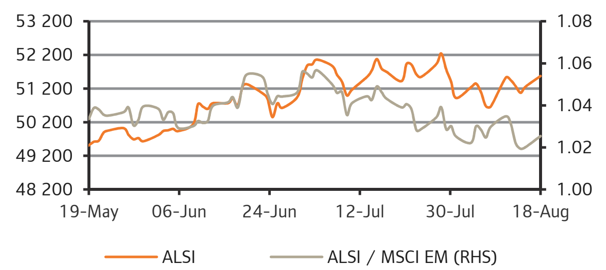

Source: Standard Bank Research, Bloomberg

### Figure 14: Bond vs. swap curves



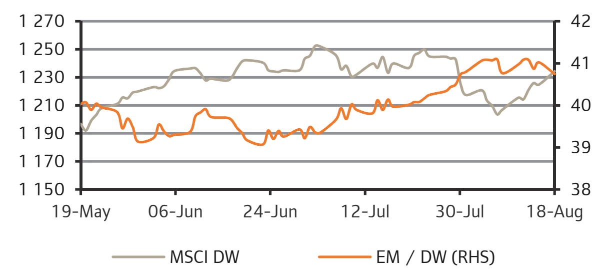

Source: Standard Bank Research, Bloomberg

### Figure 15: ALSI vs. ALSI/MSCI EM relative




Source: Standard Bank Research, Bloomberg

### Figure 16: MSCI EM vs. MSCI EM/DW relative




Source: Standard Bank Research, Bloomberg

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