



## **US dollar's surge takes us back to euro parity**

Market Report 22/08/22 - By Sam Balla-Muir

### **USD**

The US dollar surged last week, rising strongly against all other G10 currencies, including by about 2.5% against the British pound, and by 2.2% against the euro. The main reason for the US currency's strength appears to have been safe-haven flows resulting from a raft of bad news about the global economy, with figures released on Monday suggesting that activity in China is currently even weaker than many investors had feared. Meanwhile, a further leap in natural gas prices and hot wages and inflation data pointed to stagflation in the UK and Eurozone. (See the GBP and EUR sections below). Although far from without its struggles, the fact that the US economy does not look in as quite as poor shape as economies elsewhere – with US industrial production and retail figures for July pointing to continued resilience – appears to be boosting the US dollar too.

While the US economy looks set to lose some of its recent momentum, I doubt that this will necessarily put the rally in the US dollar to a halt. After all, periods of economic turmoil tend to see the US dollar rise, as global investors seek the safety provided by the world's de facto reserve currency. What's more, although not in a strong position in absolute terms, I think that the US economy will

remain in a better shape than the vast majority of its peers. For these reasons, I see the dollar making some further gains against both the pound and euro.

### **GBP**

The British pound fell by 2.5% against the US dollar and by 0.5% against the euro last week. In large part, sterling's decline against the dollar reflected a global flight to safety into USD-denominated assets (see the USD section above), and the pound and euro were probably both hurt by a further deterioration in their energy situation, with European natural gas prices rising by 20% or so last week. What's more, UK wage growth figures released on Tuesday showed a further acceleration, while other data released on Wednesday showed that UK inflation rose to above 10% in July, and indicated that price pressures are increasingly bleeding out of the energy sector into wider parts of the economy. That points to a growing risk that the UK will either have to tolerate higher inflation for an extended period, or accept that a deep recession might be needed to bring it back down. Neither scenario is a strong sell for GBP-denominated assets.

The economic backdrop in the UK is undeniably challenging, and for this reason I have correctly been calling for a weaker pound relative to the US dollar for several months now. I don't think this trend vis-à-vis the dollar has yet entirely run its course and see sterling losing further ground to the greenback from here. However, while the pound has also struggled against the euro since around the start of August, it is not clear to me why this trend should continue. The current energy crisis looks equally bad, if not worse, in mainland Europe. Meanwhile, the Eurozone faces its own structural issues which make responding to high inflation there even more challenging. (See the EUR section below).

### **EUR**

The euro had a mixed week last week, falling by 2.2% against the USD dollar, but also gaining 0.5% against the pound and holding up better than most other G10 currencies. With little in the way of notable economic data for the Eurozone last week, the euro's fall against the US dollar probably reflected both a broad-based trend towards a stronger dollar as the global economy showed further signs of faltering, but also the further deterioration in Europe's energy crisis, with natural gas and electricity prices surging on the continent yet again. That all but confirming that a lack of power and hit to consumer incomes from higher utility bills will be soon pushing the continent into recession. Perhaps the only reason why the British pound fared worse than the euro last week is that UK data released also suggested that this is also causing inflation to become more deeply imbedded in Britain's labour market and services sector. (See the GBP section above).

With the global economy clearly in a downtrend, I suspect that the safe-haven inflows which have fuelled the US dollar's gains in recent months will continue to push it up relative to the euro. Europe's energy crisis is hard to forecast, given that it depends on decisions taken by Putin's kremlin and the extent to which Europe experiences a cold autumn or winter, though these risk factors add an additional reason to think that the euro's fortunes will not improve anytime soon. I expect the euro to also lose ground relative to the pound, in part because it's energy crisis appears a bit more acute than Britain's, but also because the Eurozone's central bank, the ECB, will find it harder to raise interest rates without triggering another sovereign debt crisis, as it did in the early 2010s. Political uncertainty in Italy, with the Italian far-right expected to win September's general election, will probably make avoiding such a debt crisis even more difficult.

### The Week Ahead

A handful of data releases next week will be closely watched for what they tell us about just how much the global economy is slowing. Those releases include Tuesday's August Flash PMI business activity surveys for the US, UK and Eurozone on Tuesday, plus US data for July on durable goods orders on Wednesday. Next Thursday's ECB minutes from their July policy meeting might be relevant for the euro if they tell us more about whether policymakers favour further aggressive interest rate hikes too. Another key event to watch will be Fed Chair Jerome Powell's speech at the Jackson Hole symposium – an annual get together for the world's central bankers – on Friday. If Powell doubles down on a commitment to do what it takes to get US inflation back to the Fed's 2% target, the dollar might receive some further support.

### Last Week's Changes In Exchange Rates

Exchange Rate	%- change on week
\$ per £	-2.50
\$ per €	-2.18
€ per £	-0.46

### Key Events

Date	Market	Time (GMT)	Release/Event	Period	Previous	Analysts' Expectation
Tue. 23rd	EZ	15.15	Flash Composite PMI	Aug'	49.9	48.8
Wed. 24th	US	13.30	Durable Good Orders (% M/M)	Jul'	+2.0%	+0.6%
Fri. 26th	US	15.00	Fed Chair Powell Jackson Hole Speech	Aug'	-	-