HSBC

What did you miss last month?

Trade tensions escalate, FOMC hikes, ECB to end QE

CURRENCIES
GLOBAL

- Global trade tensions escalate, market turns risk-off
- FOMC hikes rates 25bp, raises 2018 and 2019 median "dots"
- ECB announces QE end date, rates on hold through summer 2019

Key Dates

1 June	US nonfarm payrolls stronger than expected at 223k
6 June	**ECB's Praet signals June is live meeting to debate end of QE**
June 7	UK government publishes a 'technical note' on its proposal for a 'temporary customs arrangement'
June 8-9	G7 leaders' summit: Trump does not support G7 communiqué
June 12	Trump-Kim meeting: Both parties sign an agreement for continued co-operation
	UK House of Commons rejects Lords' amendment for a 'meaningful vote'
June 13	**FOMC hikes rates by 25bp and raises median "dots"**
June 14	**ECB announces end date of QE, pledges to leave rates on hold at least through summer 2019; EUR-USD falls sharply**
June 15	**US Trade Representative announces it would impose 25% tariffs on imports from China**
	BoJ leaves rates unchanged, cuts inflation forecast
June 18	**President Trump threatens to impose new tariffs on USD200bn of imports from China**
	Reports Swedish opposition party to call for referendum on EU membership
June 19	ECB President Draghi speaks in Sintra, states ECB would remain patient and take a gradual approach to tightening after the first rate hike
June 20	FOMC Chair Powell reiterates that case for gradual rate hikes remains strong
June 21	BoE votes 6-3 to leave rates unchanged, Haldane votes for a hike
June 22	OPEC members reach compromise agreement to raise supply by up to 1m b/d
June 24	PBoC announces a 50bp reserve requirement ratio (RRR) cut
June 27	RBNZ leaves rates unchanged and reiterates symmetrical outlook for rates
June 29	EU leaders reach deal on migration; EUR rallies

Summary – Trade tensions

The USD rally continued in June, with the US Dollar Index (DXY) ending the month up 0.5%[1]. The key driver of the USD was the growing divergence between the Fed and other central banks. On 13 June, the FOMC hiked rates 25bp, while also nudging higher its median "dots" projections for 2018 and 2019. This highlighted the Fed's ongoing commitment to tighten policy. Away from cyclical drivers, the escalation of global trade tensions also supported the USD as the market shifted towards a risk-off stance.

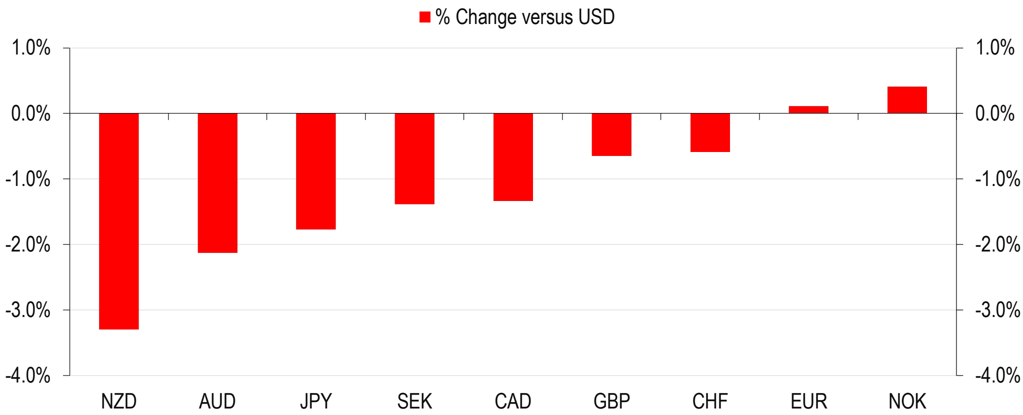
The outlook for monetary policy was the key driver of the EUR in June. The market awaited the 14 June European Central Bank (ECB) meeting as speculation suggested the central bank would announce the end date of quantitative easing (QE), a form of economic stimulus through asset purchases. The ECB did announce this, but also pledged to keep rates on hold at least through summer 2019. The EUR weakened as the market focused on the dovish rate guidance from the ECB. On the data front, the continued Eurozone slowdown could not be ignored, with weaker than expected data also weighing on the EUR. The annual ECB Forum on Central Banking was held in Sintra on 18-20 June, with President Draghi reiterating his dovish stance.

GBP remained caught between cyclical and political drivers in June. Amendments to the EU Withdrawal Bill from the House of Lords began the process of parliamentary ping pong between the House of Commons and House of Lords. GBP struggled to gain any meaningful direction from these developments. On 21 June, the Bank of England's (BoE) Monetary Policy Committee (MPC) voted 6-3 in favour of leaving rates unchanged with Andy Haldane joining the hawkish camp. GBP-USD pushed above 1.3250 as the probability of a rate hike in August rose.

For the JPY, monetary policy divergence battled escalating global trade tensions. On 15 June, the Bank of Japan (BoJ) left rates unchanged and cut its inflation forecast, seeing the JPY weaken. However, the JPY rallied as the tit-for-tat in US-China trade tensions developed. Ultimately, by month-end, the JPY was down 1.8% against the USD.

Elsewhere: The RMB weakened in June, with the People's Bank of China (PBoC) choosing to keep its reverse repo rate unchanged despite the 25bp hike from the Fed and later cutting the Reserve Requirement Ratio (RRR), the portion of a bank's deposit liabilities that are required to be held in cash, by 50bp. Global factors drove many of the higher beta currencies in G10, with the CAD, AUD, and NZD all hit by escalating trade tensions.

June G10 performance



Source: Bloomberg, HSBC

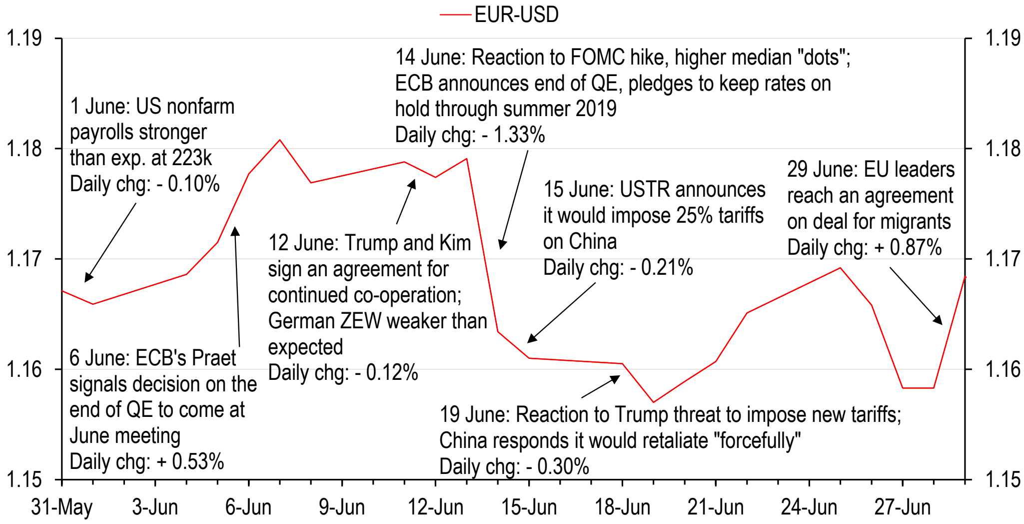
[1] All prices in this report are taken from Bloomberg

US: The dollar's on a roll

The USD continued to move higher in June, as the divergence in monetary policy between the Fed and other central banks became even more apparent. By month-end, the DXY was up 0.5%. The month kicked off with the employment report highlighting the continued US cyclical strength, as nonfarm payrolls came in stronger than expected at 223k and the unemployment rate fell to 3.8% on 1 June. On 13 June, the Fed hiked rates 25bp, as expected, while also nudging higher the median "dots" projections for 2018 and 2019. This hawkish development initially supported the USD, as EUR-USD fell towards 1.1730. However, the USD quickly reversed this move as the market digested that the shift in the 2018 "dot" only required one member to move their projection higher. On 14 June, the ECB announced the end date of QE as the end of December 2018 while also pledging to keep rates on hold at least through summer 2019. The market focused on the dovish rate guidance from the ECB, and the USD rallied across the board as the hawkish Fed provided a clear counterpoint. EUR-USD ended the day down 1.3%, as stronger than expected US retail sales also helped the USD to power ahead. At the central banking forum in Sintra on 20 June, Chair Powell reiterated that the case for gradual rate hikes remained "strong", keeping the USD supported.

Geopolitical factors were also a driver of the USD in June. Ahead of the G7 summit on 8-9 June, fears of a global trade war picked up. These tensions remained elevated following the summit, as President Trump did not support the G7 communiqué and added that the US was looking at tariffs on auto imports. With tensions high the market shifted towards a risk-off stance, supporting the USD rally. In contrast to escalating global trade tensions, relations between the US and North Korea improved in June. Following the meeting between US President Trump and North Korean leader Kim Jong Un on 12 June, both parties signed an agreement for continued co-operation, tempering some of the risk-off sentiment that was supporting the USD. On 15 June, the US Trade Representative announced that it would impose 25% tariffs on a range of products from China, a move that later saw China announce retaliatory measures. The tit-for-tat continued, as Trump threatened new tariffs on USD200bn of imports from China on 18 June, and China responded that it would retaliate "forcefully". This pushed the USD higher the following day.

EUR-USD



Source: Bloomberg, HSBC

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Eurozone: ECB blows the whistle on QE

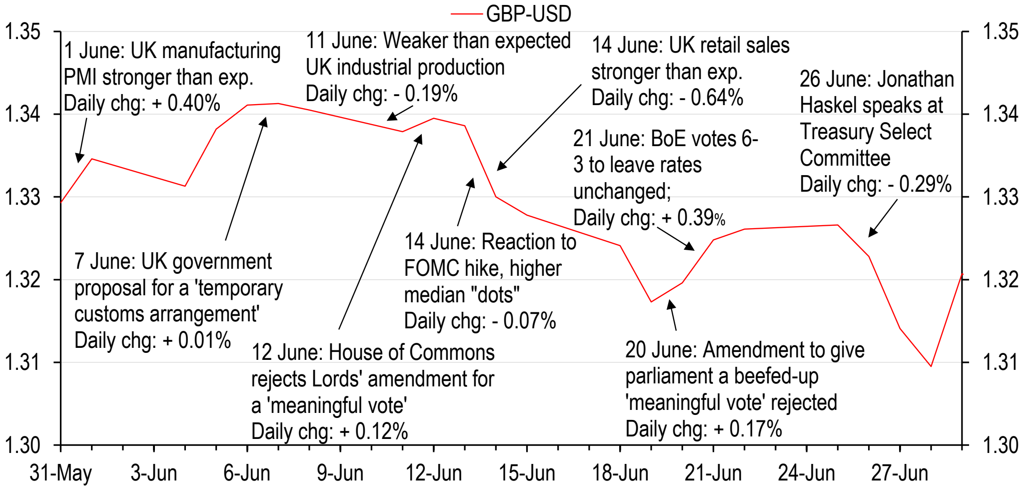
The outlook for monetary policy was the key driver of the EUR in June. At the beginning of the month, the EUR moved higher as speculation grew that the 14 June would be the live ECB meeting to debate the end of QE. In a speech on 6 June, ECB chief economist Peter Praet gave a further signal that the ECB could give a decision on the end of QE at this meeting. Subsequently, EUR-USD pushed higher to 1.18. But the continued Eurozone slowdown could not be ignored and a string of weaker than expected data kept a lid on further EUR gains. German factory orders came in worse than expected on 7 June, before both German and France industrial production printed softer than expected on 8 June. German ZEW, a measure of economic sentiment, slowed by more than expected on 12 June, exacerbating the downward cyclical pressure on the EUR. At its meeting on 14 June, the ECB announced the end date of QE would be the end of December 2018, while also pledging to keep rates on hold at least through summer 2019. The market focused on the dovish rate guidance from the ECB, and EUR-USD fell almost three big figures to below 1.16 as the hawkish Fed provided a clear counterpoint. The annual ECB Forum on Central Banking was held in Sintra on 18-20 June. In a speech, President Draghi reiterated his dovish stance, suggesting that the ECB would remain patient and take a gradual approach to tightening after the first rate hike. At the end of the month, the EUR strengthened after EU leaders reached an agreement on a deal on migration.

UK: Sterling dribbles lower

GBP remained caught between cyclical and political drivers, as both the possibility of future hikes by the BoE and amendments to the EU Withdrawal Bill were a focus, ending the month down 0.7% against the USD. On 7 June, the UK government published a ‘technical note’ on its proposal for a ‘temporary customs arrangement’ as a backstop in case a full trade deal with the EU was not reached in time, with the market reaction seeing GBP choppy but unchanged. The passage of the EU Withdrawal Bill came in focus. 15 proposed amendments by the House of Lords, and one from the opposition Labour party, which called for “full access to the internal market of the European Union”, were debated as the process of Parliamentary ping pong unfolded between the House of Commons and House of Lords. On 12 June, the House of Commons rejected the Lords’ amendment to give parliament a ‘meaningful vote’ on the Brexit deal. However, the government did reportedly make a concession suggesting it would beef up the vote it offered MPs. GBP bounced somewhat higher as the government avoided defeat on the bill. The amendment to give parliament a beefed up ‘meaningful vote’ on the final Brexit deal was then rejected on 20 June. GBP struggled to gain any meaningful direction from these developments, as the GBP-positive win for the government battled the increased likelihood of a hard Brexit.

From a cyclical standpoint, the key driver of GBP was the prospect of a rate hike from the BoE later in the year. Following a run of weaker than expected data, releases in June were broadly mixed. The month started off positively, with the manufacturing PMI coming in stronger than expected on 1 June, before both British Retail Consortium (BRC) sales and services PMIs bounced back on 5 June. These releases helped push GBP-USD above 1.34. However, GBP weakened as industrial production and trade balance data disappointed on 11 June. The labour market and inflation report, released on 12 and 13 June respectively, produced no surprises to the market, while retail sales beat expectations on 14 June. In light of the sluggish start to the year for the UK economy, none of the 61 estimates received by Bloomberg was looking for a rate hike at the BoE’s meeting on 21 June. The focus was instead on the signal for future tightening later in the year. At the meeting, the BoE’s MPC voted 6-3 in favour of leaving rates unchanged. The shift of chief economist Andy Haldane into the hawkish camp, combined with an upbeat set of minutes, saw the probability of a hike in August rise, pushing GBP-USD above 1.3250. Some of these gains were reversed on 26 June as Jonathan Haskel, Ian McCafferty's replacement, spoke at the Treasury Select Committee. Despite a balanced tone, the market focused on Haskel's comment that he "sees risks if rates are raised too quickly". By month-end the probability of a rate hike in August had risen to 73%, and GBP had fallen to its lowest level in seven months.

GBP-USD

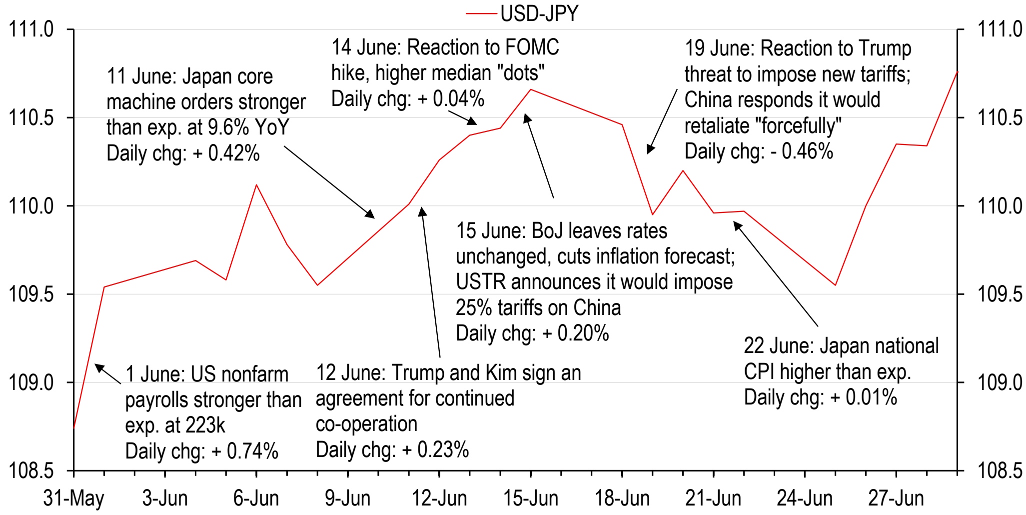


Source: Bloomberg, HSBC

Japan: Trade tensions through to the next round

For the JPY, the focus on monetary policy divergence outweighed global trade tensions, as the currency ended the month down 1.8%. The JPY initially weakened on the broad risk-on move following the improvement of geopolitical relations between the US and North Korea. USD-JPY pushed above 110.50 following the Trump-Kim meeting on 12 June, as both parties signed an agreement for continued co-operation. On 15 June, the BoJ left rates unchanged and cut its inflation forecast. This stood in stark contrast to the Fed, which had just hiked a further 25bp and raised its median "dots", pushing USD-JPY higher. As the tit-for-tat in US-China trade tensions developed, the JPY began to reverse weakness sustained earlier in the month on a broad risk-off move. The JPY gained 0.5% against the USD on 19 June following US President Trump's threat the previous day of new tariffs on USD200bn of imports from China, which China later said it would retaliate "forcefully" to. Heightened trade tensions failed to support the JPY into month-end, as USD-JPY rallied back towards 111.

USD-JPY



Source: Bloomberg, HSBC

China: The RMB trades weaker

The RMB moved broadly sideways in the first half of the month despite a run of weaker than expected data. Trade data released on 8 June showed a smaller than expected surplus. Despite the Fed's 25bp hike and higher "dots" projections on 13 June, the PBoC kept its reverse repo rate unchanged. On 14 June, activity data for May came in weaker than expected across the board, as infrastructure investment growth slowed to an all-time of low of 2.3% y-o-y. The depreciation of the RMB kick-started in the second half of the month, as trade tensions between the US and China escalated and the PBoC modestly loosened policy. On 15 June, the United States Trade Representative (USTR) announced that it would impose 25% tariffs on a range of products from China, a move that later saw China announce retaliatory measures. This saw USD-CNY push higher to 6.45. The threat of new tariffs on USD200bn of imports from China by US President Trump on 18 June, and the response from China that it would retaliate "forcefully", put further pressure on the RMB. On 24 June, the PBoC announced a 50bp RRR cut for a large number of banks. USD-CNY continued its move higher, reaching a year-to-date high of 6.6425 on 29 June. By month-end, the RMB was 3.3% weaker against the USD.

Canada: Trade kicks off

Escalating trade tensions weighed on the CAD in June, ending the month down 1.3% against the USD. Data also broadly disappointed expectations as the market considered whether the Bank of Canada (BoC) could keep up with the Fed's tightening. Both housing starts and building permits came in weaker than expected at the start of the month. The employment report released on 8 June showed employment unexpectedly falling 7.5k in May (consensus +23.5k), driven by a large decline in the full-time component. On 11 June, the CAD came under pressure as US-Canada relations deteriorated following the G7 summit, increasing the risk of a tit-for-tat escalation in trade tensions between the two nations. The USD bounce and shift to a risk-off tone following rising global trade tensions put the CAD under further pressure. USD-CAD rose to a fresh 12- month high of 1.3386 on 28 June.

Australia & New Zealand: Cornered

The AUD was another currency in G10 hit by a risk-off move and a stronger USD. The AUD did manage some brief strength at the beginning of the month, as both retail sales and GDP came in stronger than expected on 4 June and 6 June, respectively. This pushed AUD-USD above 0.7650, with unchanged rates from the Reserve Bank of Australia (RBA) prompting a muted reaction from the market. But the AUD began to reverse these gains ahead of the G7 summit on 8/9 June, as hopes for some cooling of global trade tensions began to fade. On 13 June, RBA Governor Lowe's comment that the next move in interest rates was likely to be up provided the AUD with some fleeting support. However, the AUD continued to weaken on a broad risk-off move as trade tensions between the US and China escalated and the USD bounced. This saw AUD-USD fall towards 0.7450. The RBA minutes, released on 19 June, excluded the phrase that it was more likely the next move in the cash rate would be up, rather than down. The AUD weakened, with its decline magnified by the broader risk-off move. By month-end the AUD was 2.1% weaker against the USD.

In similar fashion to its antipodean neighbour, the NZD also took a hit from escalating trade tensions and a stronger USD. The NZD traded broadly sideways until the middle of the month when the market shifted to a risk-off stance. On 15 June, the NZD fell 0.6% as tit-for-tat in US-China trade tensions developed. GDP fell to 0.5% q-o-q on 20 June, in line with expectations, confirming the market's assessment that growth momentum was slowing. This saw NZD-USD fall to 0.6850. Ahead of the RBNZ meeting, the NZD struggled to hold its ground as business confidence fell on 27 June. At its meeting later on 27 June, the Reserve Bank of New Zealand (RBNZ) left rates unchanged and reiterated the symmetrical outlook for rates, stating that the central bank is "well positioned to manage change in either direction – up or down". By month-end, the NZD was 3.3% weaker against the USD.

Oil: A month of two halves

The key driver of oil for most of June was the possibility of an agreement for a supply increase at the OPEC meeting on 22 June. Oil began the month under pressure amid growing speculation of an increase in output. This saw Brent crude drop to around USD74/barrel on 5 June. Fundamental data also weighed on oil, as an unexpected increase in crude inventories kept Brent crude under pressure on 6 June. Oil did briefly bounce back the following day (7 June), after reports emerged that Venezuela was almost a month behind on its crude delivery. As we neared the OPEC meeting, the possibility of an output hike dominated. On 15 June, reports that Saudi Arabia and Russia had proposed an increase in crude supply saw oil fall, with Brent crude dipping below USD73/barrel. A Bloomberg headline on 18 June, stating that the hike in output would be from 300k to 600k barrels per day, saw oil recover some of its losses as the market viewed this as a smaller rise than anticipated. Oil moved higher on 22 June, after OPEC members reached a compromise agreement to raise supply by up to 1m barrels per day from July. Reports on 26 June stating that the US wanted its allies to stop importing oil from Iran saw Brent crude rally above USD79/barrel by month-end. Having recovered its earlier losses, Brent crude ended June up 2.4%.

Precious Metals: Gold penalised in June

Gold came under pressure from a strong USD in June, as geopolitical developments and rising trade tensions were not enough to support the yellow metal. Bullion began the month moving lower, as the US employment report came in stronger than expected on 1 June and pushed the USD higher. On 5 June a small dip in both the USD and yields, combined with an uptick in global trade tensions, saw gold recover some of its prior losses. A softening of equities helped propel gold to the month's high of USD1,309.37/oz on 14 June. However, gold fell sharply from this high to below 1280USD/oz the next day (15 June), as the market caught up with the strong USD rally seen after the Fed and ECB meetings. Despite global trade escalations and higher oil, gold continued to move lower, ending the month down 3.8%.

Other precious metals also weakened this month, hit by rising trade tensions. Platinum was the worst performer, ending the month down 6.2%. Platinum-group metals (PGMs) came under pressure from auto-related trade concerns, despite South Africa data showing a drop in PGM output of 6.5% y-o-y in April. Silver was supported by strong demand for base metals and higher copper prices, but ultimately weighed down by the weakness of gold, ending the month down at USD16/oz.

Movers in June vs USD

NZD	-3.3%
AUD	-2.1%
JPY	-1.8%

Upcoming key events

Date	Event
5 July	**FOMC** meeting minutes
11 July	**BoC** rate announcement
26 July	**ECB** rate announcement
31 July	**BoJ** rate announcement

Commodities

Gold	-3.8%
Brent Crude Oil	+2.4%

Source: Bloomberg

Disclosure appendix

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