Bank of Nassau
SINCE 1982

Economy Week Ahead

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"Economics is not an exact science. It's a combination of an art and elements of science."

Paul Samuelson

Markets are still digesting last week's FOMC decision. Despite the hawkish hold with three dissents, UST yields at the long end of the curve are making new highs for this move. To us, this signals discomfort with the lack of any clear signals from Chair Warsh on how he plans to get inflation back to the 2% target. If the bond market calls Warsh's bluff as we expect and yields continue to rise, equity markets are likely to come under greater pressure.

This week brings key US economic data that culminates in the jobs report Friday. For now, the Fed can focus on its price stability mandate but if the labor market shows any signs of further weakness, a policy dilemma may emerge. Markets will be on alert for further FX intervention to boost the yen after the US and Japan undertook coordinated action last week.

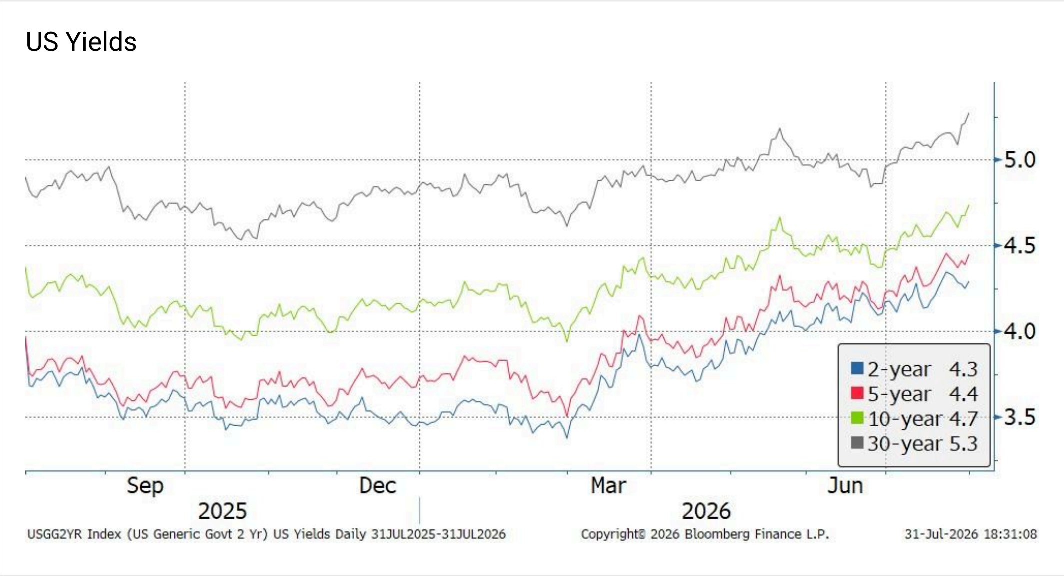
Geopolitics

President Trump announced that the US would hold off on any new strikes on Iran "subject to being able to rapidly make a DEAL." He claimed that US regional allies have reached the parameters of a deal with Iran that "would include the Immediate, Complete, and Total OPENING OF THE HORMUZ STRAIT, and an end to Iran's nuclear threat." Reports later emerged that Saudi Arabia had urged Trump not to attack Iran after a proposal was made to get the US and Iran back at the negotiating table. Other reports suggest that under this proposal, Iran would reopen the Strait of Hormuz and halt all attacks in the region while the US would end its naval blockade of Iran and allow it to resume oil exports. While this pause may help calm markets, we need to see more progress on the diplomatic front in order to get a lasting peace.

Americas

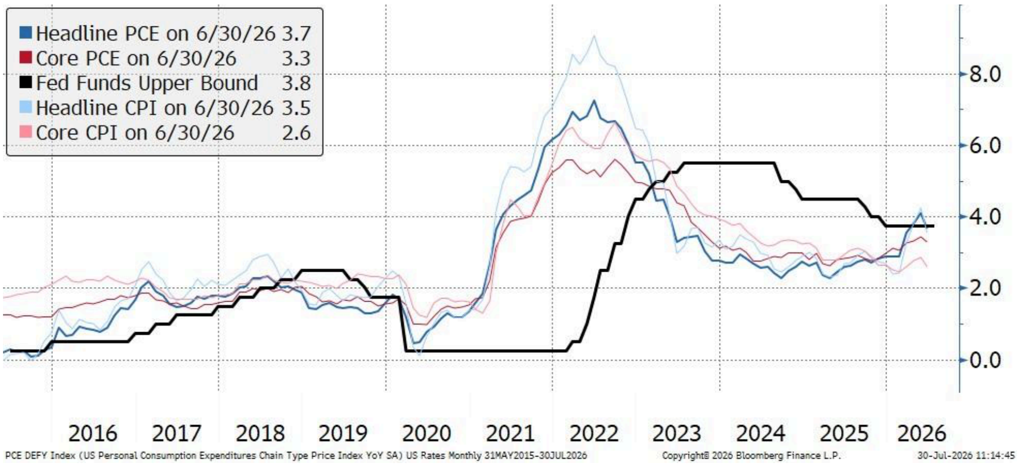
Markets are still digesting last week's FOMC meeting. Please see our postmortem here. There was clear disappointment with Warsh's performance and that is manifesting in UST yields making new highs last week, with the 10-year trading near 4.75% and the 30-year trading near 5.28%. We think the market is calling Warsh's bluff and things could get ugly when the equity market wakes up to the fact that yields are going even higher. Near-term targets for the 10-year yield is the 5.02% high from October 2023 and then the 5.32% high from June 2007. For the 30-year yield, look for a test of the June 2007 high near 5.44% and then possibly the May 2004 high near 5.59%. If yields get that high, we'd expect a pretty big equity market correction.

Making matters worse, reports emerged ahead of the weekend that Chair Warsh raised the possibility of reducing the number of FOMC meetings per year from the current eight. We will be writing a longer piece on the Fed's meeting schedule later this week. Our understanding is that the current schedule is not enshrined in law and that the Chair or any three members of the FOMC can call a meeting. It remains to be seen how other Fed officials feel about the proposal but just the fact that Warsh is suggesting this is worrisome. We believe the Fed plays a central role in global financial markets and is much more than just a referee. There is such a thing as too little information and guidance from the Fed, and leaving everything up to the markets is a dangerous premise. Even former Chair Greenspan admitted in his 2008 Congressional testimony about the Great Financial Crisis that his assumptions about the role of the free market were wrong



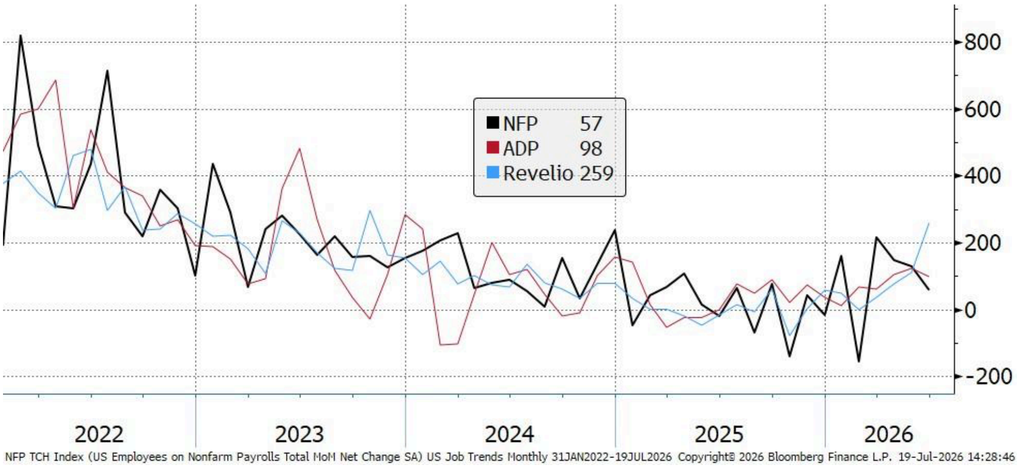
Given the poor market reaction to the FOMC decision, we expect Fed officials to conduct damage control this week. Schmid speaks Tuesday. Cook and Daly speak Wednesday. Musalem speaks Thursday. Barkin speaks Friday. Bowman speaks Saturday. Of note, the market sees over 70% odds of a hike at the September 15-16 FOMC meeting and is fully priced in for October 27-28. Last Friday, the three dissents explained their reasoning behind their dissents. Hammack said "The longer that high inflation persists, the more challenging and costly it can be to bring it back down." Kashkari said he "would rather tighten policy incrementally as we gather more data on the path of inflation and employment." Lastly, Logan said that "modest action in the near term would reduce the likelihood of needing to take sharper action later."

US Rates

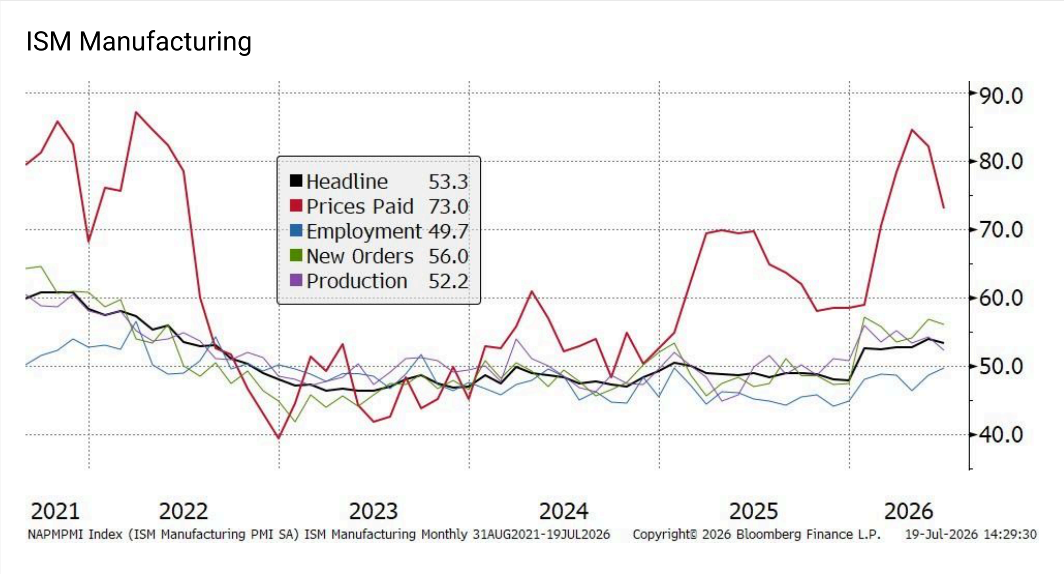


The data highlight will be the July jobs report Friday. Bloomberg consensus for NFP is 85k while its whisper number stands at 78k. We note that NFP peaked at 214k in March and has fallen three straight months to 57k in June. The unemployment rate is expected to remain steady at 4.2% while average hourly earnings are expected to remain steady at 3.5% y/y. Recall that the main reason the unemployment rate fell a tick in June was that the -720k drop in the labor force more than offset the -507k drop in jobs reported in the household survey. Ahead of the jobs report, ADP reports its private sector jobs estimate Wednesday and is expected at 68k vs. 98k in June. Revelio reports its estimate Thursday but there is no consensus estimate.

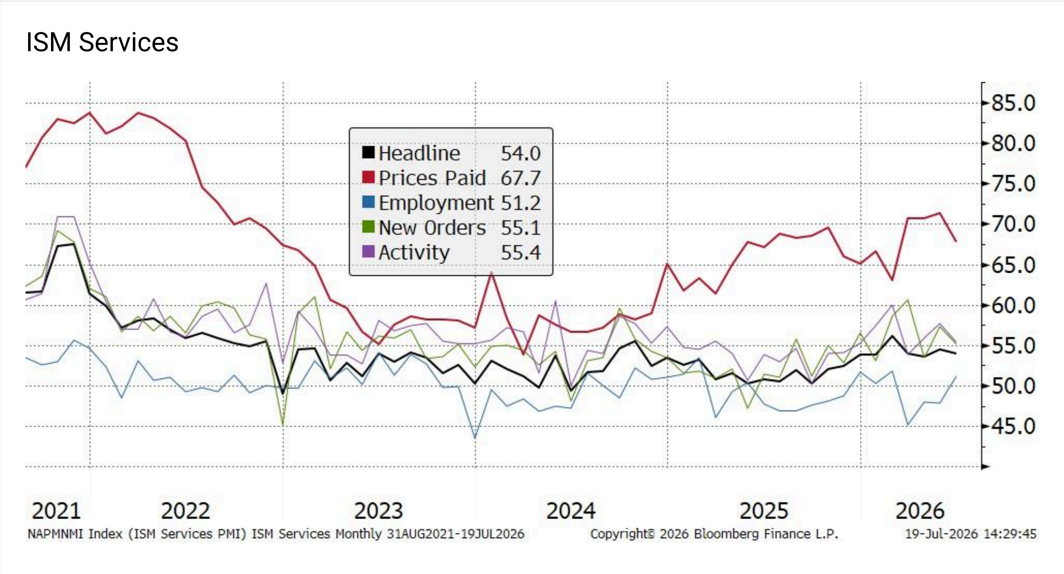
US Jobs, 000s



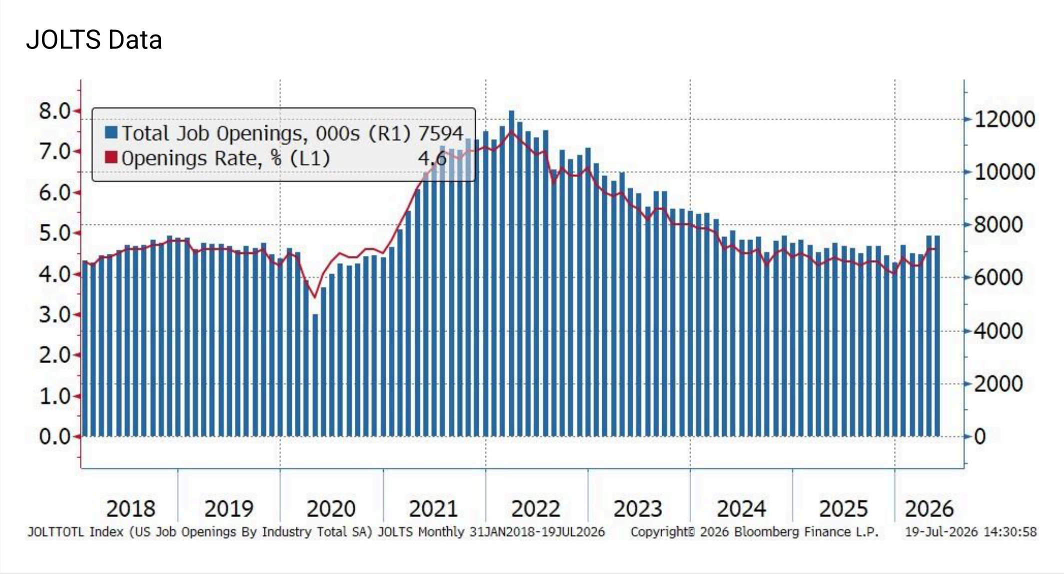
ISM PMIs will be reported this week. Manufacturing PMI will be reported Monday and headline is expected to rise six ticks to 53.9. Prices paid are expected to fall three points to 70.0, new orders are expected to rise a point to 57.0, and employment is expected to rise three ticks to 50.0. Last week, S&P Global manufacturing PMI fell a tick to 53.8.



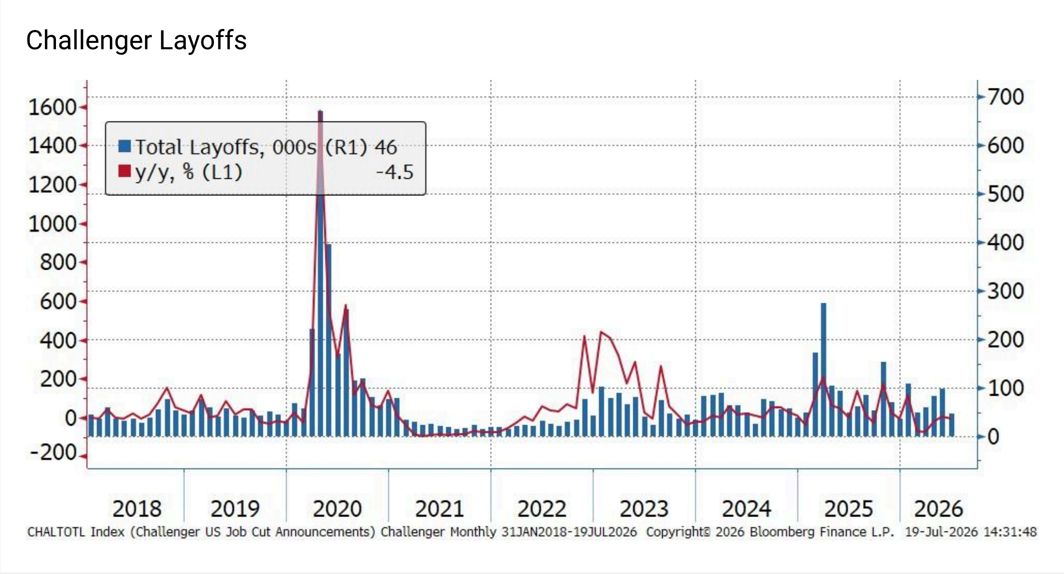
ISM services PMI will be reported Wednesday and headline is expected to rise half a point to 54.5. Prices paid are expected to fall nearly three points to 65.0 and employment is expected to fall two ticks to 51.0. Last week, S&P Global services PMI rose nearly two and a half points to 53.6.



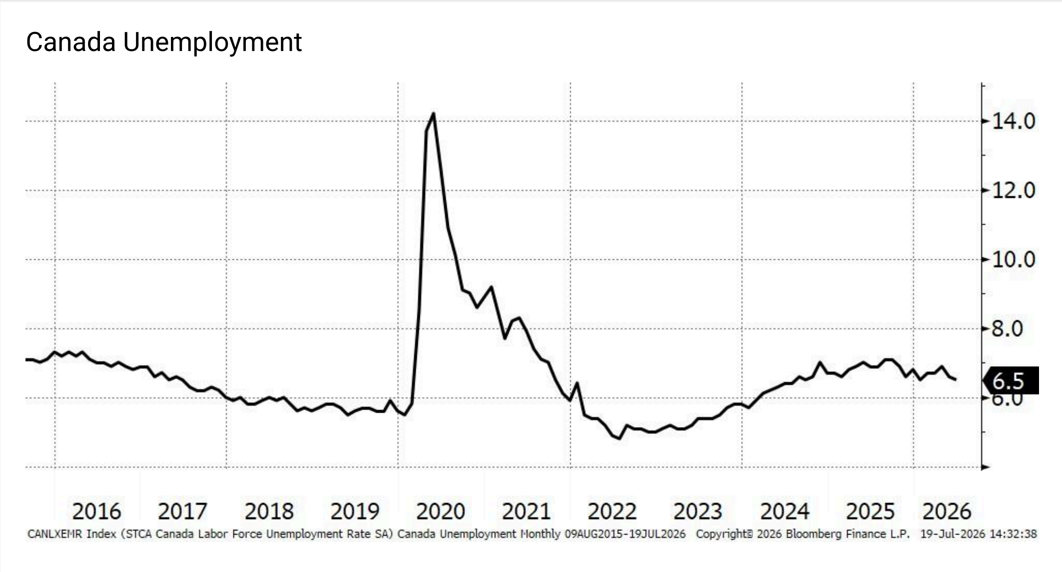
June JOLTS data will be reported Wednesday. Openings are expected at 7501k vs. 7594k in May. If so, the openings rate would likely fall from 4.6% in May and might test the 4.5% threshold that typically signals a significant rise in the unemployment rate. Such an outcome would suggest that the labor market remains vulnerable.



July Challenger layoffs will be reported Thursday. After the June report, Challenger wrote that "The pace of layoffs cooled considerably in June, similar to plans last June, and as is typical for summer months. That said, the cuts we are seeing remain concentrated in technology, and artificial intelligence continues to reshape how companies think about headcount."



Canada data highlight will also be the July jobs report Friday. Consensus sees 15.0k jobs created vs. 18.2k in June, while the unemployment rate is expected to remain steady at 6.5%. At the July 15 meeting, the Bank of Canada kept rates steady at 2.25% and reiterated that current policy settings remain appropriate. The bank was fairly upbeat, noting that “After a year of weakness, Canada’s economy is showing signs of improvement. Growth is expected to pick up, and inflation eases gradually from its recent peak. Uncertainty is still high.” June CPI data came in softer than expected so we shall see if the jobs data also reflects the bank’s optimism. A hike is not priced in until January.

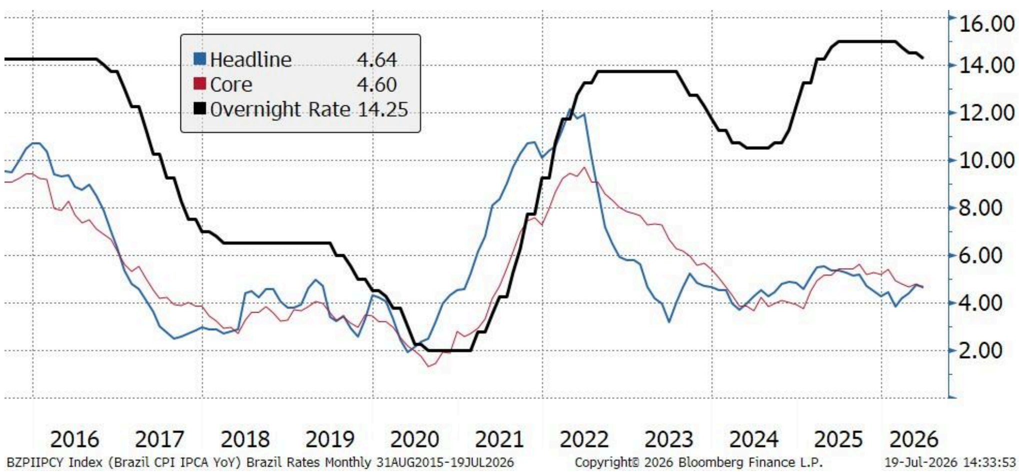


Canada also reports July PMIs this week. S&P Global reports its manufacturing PMI Tuesday, followed by its services and composite PMIs Thursday. Ivey PMI will be reported Friday. Of note, Statistics Canada estimated last week that Q2 GDP grew 0.8% q/q vs. a flat q/q reading in Q1. If so, this would certainly support the BOC’s more upbeat outlook. However, the official estimate won’t be reported until August 28.

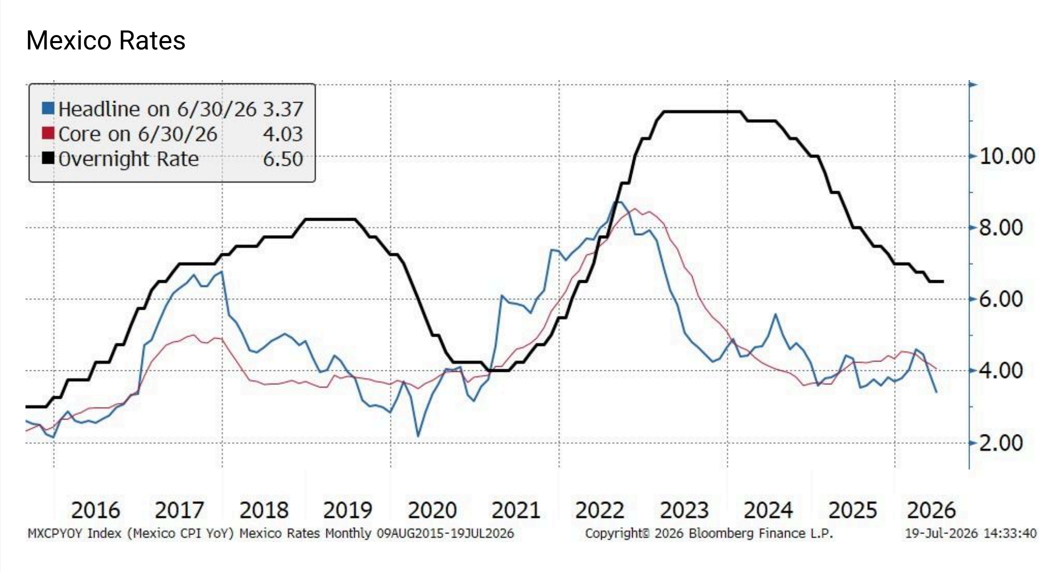
Canada PMIs

Banco Central do Brasil meets Wednesday and is expected to cut rates 25 bp to 14.0%. At the last meeting June 17, the central bank cut rates 25 bp to 14.25% and noted that "The global environment remains uncertain due to the lack of definition on the terms of the agreement for the end of the armed conflicts in the Middle East, and the consequences of the already materialized effects of these conflicts until this moment, altering global financial conditions." Since then, IPCA inflation slowed modestly to 4.64% y/y in July from 4.72% in June. This was the first deceleration since February but remains above the 1.5-4.5% target range. The swaps market sees around 60% odds of one last cut at the next meeting September 16.

Brazil Rates

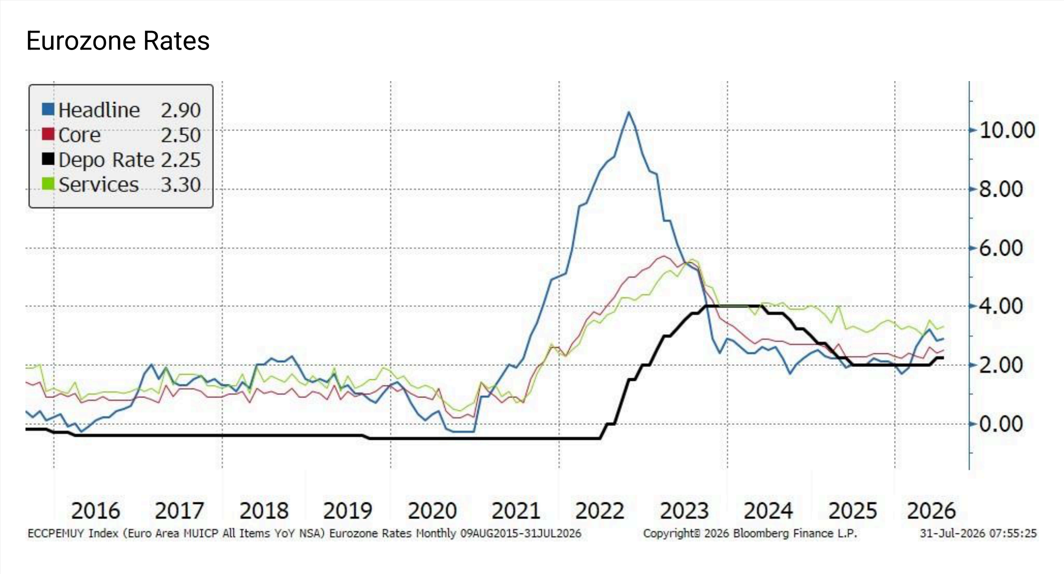


Banco de Mexico meets Thursday and is expected to keep rates steady at 6.5%. At the last meeting June 25, the central bank kept rates steady at 6.5% in a unanimous decision and noted that “Looking ahead, the Governing Board estimates that it will be appropriate to maintain the reference rate at its current level.” The swaps market is pricing in the start of a tightening cycle with a 25 bp hike over the next six months. Mexico then reports July CPI data Friday. Headline is expected at 3.11% y/y vs. 3.37% in June and core is expected at 3.94% y/y vs. 4.03% in June. If disinflation continues, the market may push out its tightening expectations.

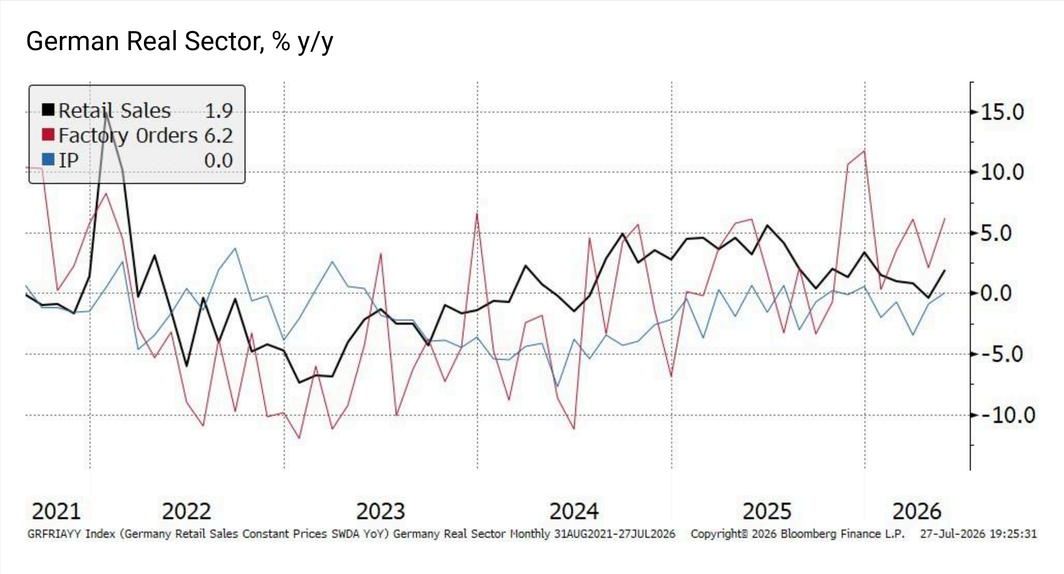


Europe

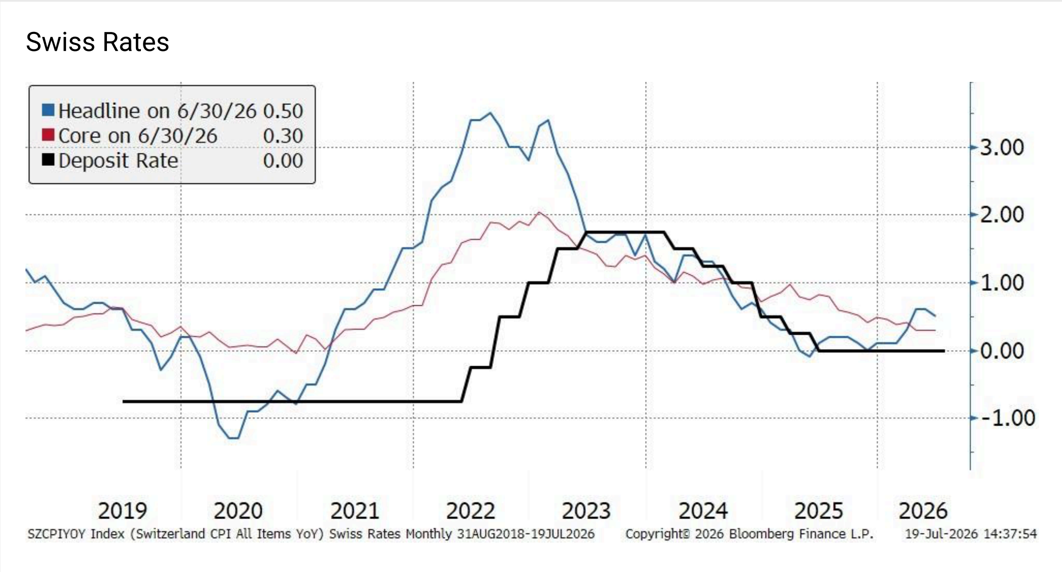
Eurozone preliminary July CPI data last week showed what most of us already knew. That is, the breakdown of the Iran ceasefire has led inflation to pick up again after a month of relief in June. We will get August CPI data before the next ECB decision September 10. If inflation continues to pick up as we expect, a hike then gets baked in the cake. Right now, odds are around 90%. Every central bank seems to be saying there are no second round effects yet but if the Iran conflict persists past the summer, inflation risks rise significantly.



Germany reports key June real sector data this week. Retail sales will be reported Monday and are expected at 2.7% y/y vs. -2.9% in May. Factory orders will be reported Thursday and are expected to slow four ticks to 5.8% y/y. IP and trade data will be reported Friday. IP is expected to remain steady at 0.0% y/y, while exports are expected at -0.5% m/m vs. 0.9% in May and imports are expected at 1.0% m/m vs. -2.5% in May. German survey indicators suggest the economy is picking up, but this will be complicated by the resumption of hostilities between the US and Iran.



Switzerland reports July CPI data Monday. Headline is expected to slow a tick to 0.4% y/y and core is expected to remain steady at 0.3% y/y. If so, headline would fall further below the Swiss National Bank's 2026 and 2027 forecasts of 0.6%. Reports emerged last week that the bank is likely to keep rates steady until the end of 2027 before starting a tightening cycle. It added that this outlook is based mainly on its current forecasts for inflation and assumes no major new shocks. It is also reportedly based on recent Swiss franc weakness against the euro. The bank next meets September 24 and no change is expected. Despite this report, the swaps market still sees 25 bp of total tightening over the next twelve months.

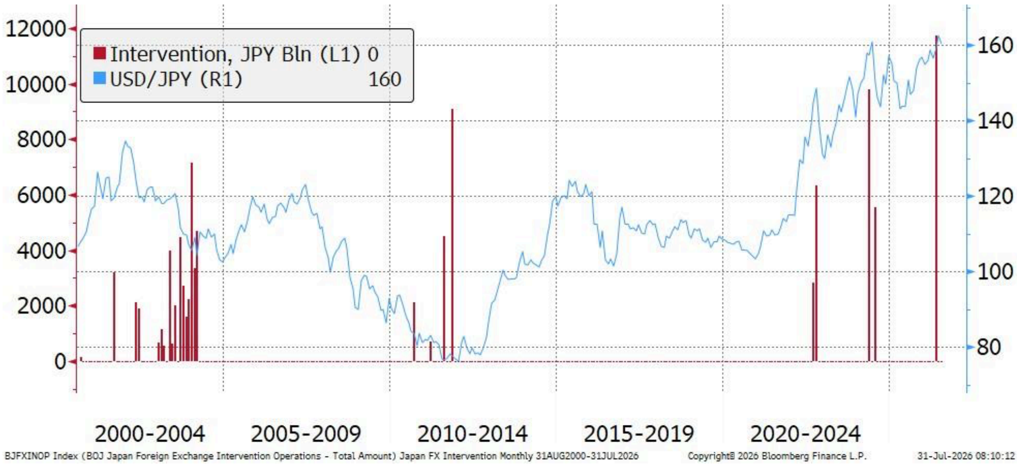


Asia

Markets should remain on alert for further Bank of Japan intervention to support the yen. Policymaker confirmed intervention last Thursday, with market estimates that it spent around JPY8.45 trln. This is less than the JPY11.7 trln reported for the April-May interventions but reports later emerged that the Bank of Japan conducted intervention on Friday as well, so that total will rise. Unfortunately, the BOJ did not deliver a surprise hike last Friday (see below), which we think would have made this intervention much more effective.

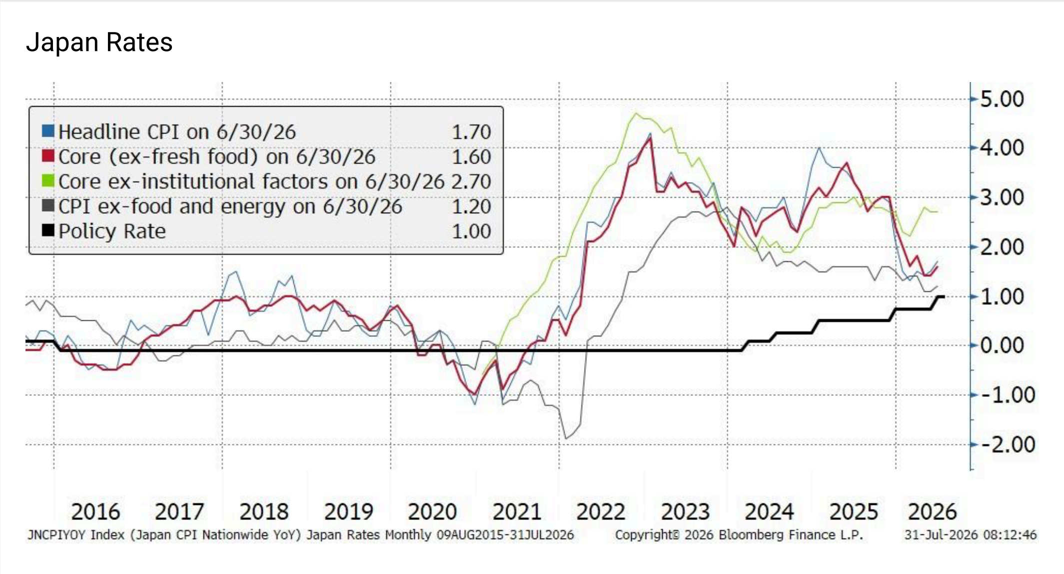
More importantly, reports also emerged that the Fed conducted FX intervention Friday on the behalf of Treasury. This is very different than intervention on behalf of the BOJ as it represents a great degree of coordination. Treasury Secretary Bessent also talked up the yen, noting that it is "very undervalued." Finance Minister Katayama piled on, noting that "Bessent, one of the most knowledgeable experts in markets, has stated that the economic and fiscal policies of our Takaichi administration will lead to a strong Japanese economy. He is sending a very clear message that once these policies manifest as economic fundamentals, the market will recognize the yen's undervaluation. It is extremely important that we are getting this very clear message." It's too early to say that we've entered a new phase of currency cooperation but the US actions are noteworthy. We do know that the Trump administration favors a weaker dollar and was likely uncomfortable with recent dollar strength and so coordination with Japan makes sense from that perspective.

Japan FX Intervention

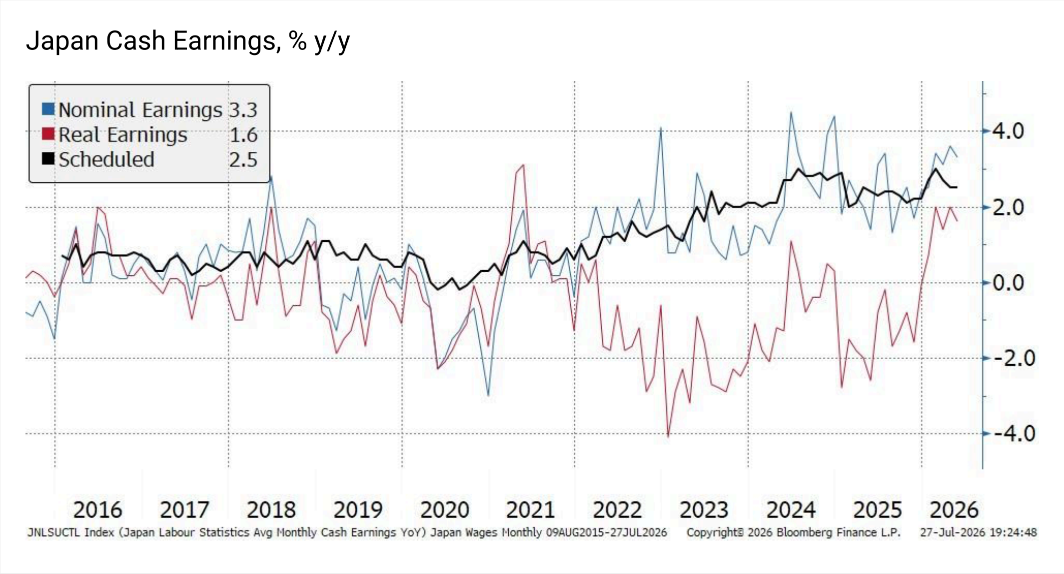


Bank of Japan releases the minutes of its June meeting Wednesday. At that meeting, the bank hiked rates 25 bp to 1.0% and signaled further tightening ahead. However, this is old news after the BOJ just delivered a hawkish hold at its July 30-31 meeting. The vote was 8-1, with board member Takata voting for another 25 bp hike. Governor Ueda noted that "Given that underlying inflation is approaching our 2% price stability target, it is necessary to be more mindful than before of upside risks to prices. With that recognition in mind, we intend to have thorough discussions from the next policy meeting onward." He added that "If we come to the view that financial conditions are too accommodative while closely monitoring inflation developments, it could well accelerate the pace of interest rate hikes."

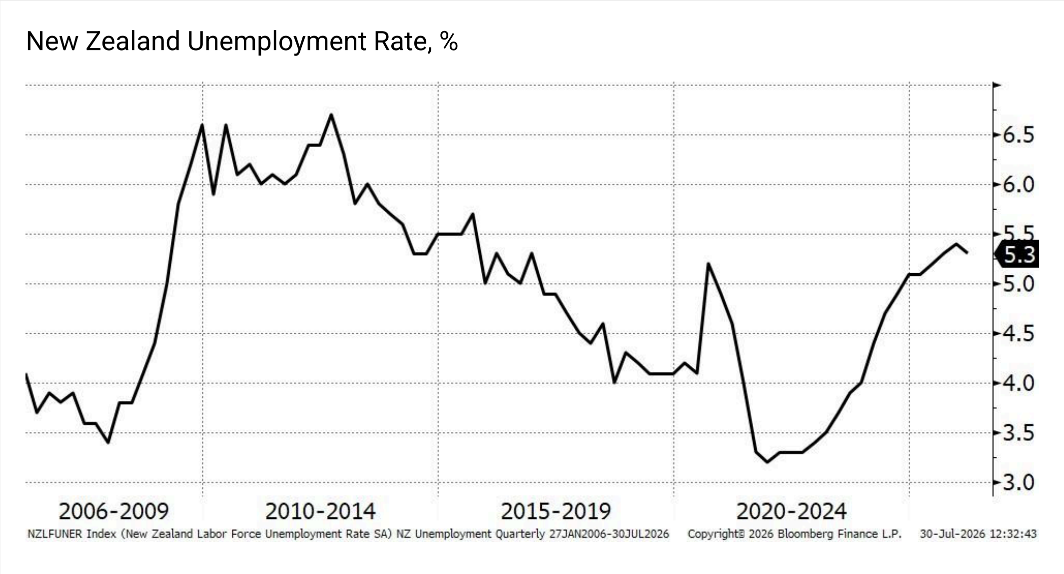
Indeed, Tokyo CPI was reported just before the decision and came in hotter than expected as core (ex-fresh food) accelerated for the second straight month to 1.9% y/y. This was the highest since January and points to upside risks for the national CPI readings. If one looks at the BOJ's underlying measure of core inflation (ex-institutional factors), it rose 2.7% y/y in June. The market sees over 40% odds of a BOJ hike at the September 17-18 meeting, rising to nearly 90% at the October 29-30 meeting.



Japan data highlight will be June cash earnings data Wednesday. Nominal earnings are expected to pick up a tick to 3.4% y/y, real earnings are expected to remain steady at 1.6% y/y, and scheduled full-time pay is expected to pick up two ticks to 2.7% y/y. Wage growth is picking up, albeit slowly, but it's enough to keep the BOJ on its tightening path.

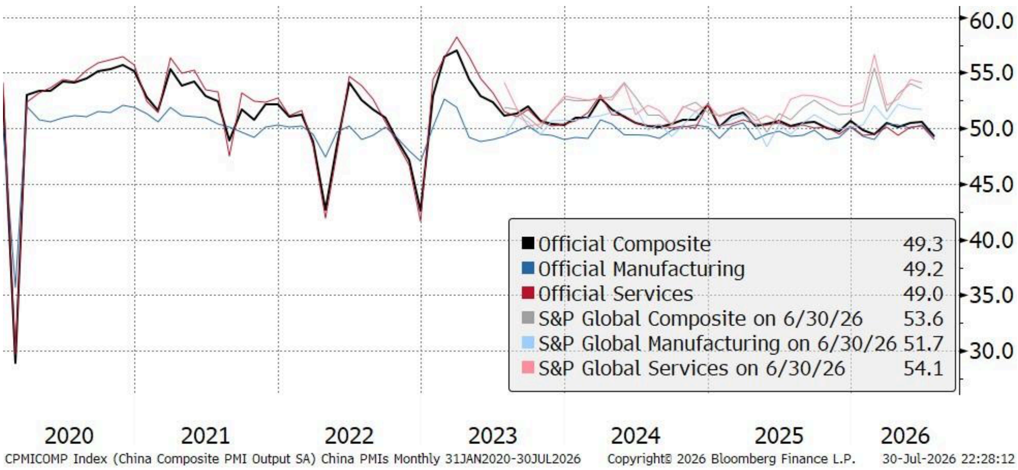


New Zealand highlight will be Q2 labor market data Wednesday. The unemployment rate is expected to rise a tick to 5.4%, with employment growth expected to remain steady at 0.1% q/q. If so, the rise would reverse the drop seen in Q1 and would put unemployment back at the cycle high. Yet the Reserve Bank of New Zealand seems dead set on continuing its tightening cycle. Another 25 bp hike at the next meeting September 2 is nearly priced in. Looking ahead, the swaps market is pricing in over 100 bp of total tightening over the next twelve months, which seems too aggressive.



S&P Global reports July PMIs for China Monday. Manufacturing is expected to rise three ticks to 52.0 and services is expected to fall four ticks to 53.7. Last week, the official PMIs came in much weaker than expected, with both manufacturing and non-manufacturing falling more than a point to 49.2 and 49.0, respectively. As such, we see downside risks to the S&P Global readings. The economy is clearly losing some steam as the Iran conflict drags on but we suspect policymakers are waiting to gauge the full impact before injecting stimulus. When all is said and done, we expect growth to come close to the target of "around 4.5%" this year.

China PMIs



Korea reports July CPI data Tuesday. Headline is expected to slow three ticks to 2.9% y/y and core is expected to remain steady at 2.5% y/y. If so, headline would decelerate for the first time since January but would remain well above the 2% target. With the economy humming along at a nearly 4% y/y pace in both Q1 and Q2, it's no wonder the Bank of Korea started a tightening cycle with a 25 bp hike to 2.75% at its July 16 meeting and signaled further tightening to come. Next meeting is August 27 and another 25 bp hike seems likely.

Korea Rates