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Market Update

July 2021

This bulletin covers:

- Sterling holds steady post Brexit giving UK exporters much needed relief
- Which way next for USD in the Biden era and
- Is inflation here to stay? Or just here for now?

FX Markets: You may recall that since the middle of last year we called an 85p-95p range in EUR/GBP depending on a soft versus hard Brexit outcome. The hard Brexit was avoided, and the rate has duly obliged heading down towards and hanging around 85p.

- The 2021 trend is obvious from Chart 1 – having peaked around EUR/GBP0.8700 towards the end of April, GBP has steadily strengthened since and has stayed below 86p since the start of this month. The average rate for June was also marginally below EUR/GBP0.8600 (compared to EUR/GBP0.9059 in December 2020).

- This trend has been very beneficial to exporters and has helped offset some of the increased costs experienced elsewhere.

- In Chart 2 overleaf, we look at how the average EUR/GBP rate has trended over the years since 2015. What is notable is that since July 2016, the average rate has been below EUR/GBP0.8500 for five months only with the average for the period since 2015 (which includes a period of very strong GBP in 2015 and 2016 up to the Brexit vote) at EURGBP0.8473.

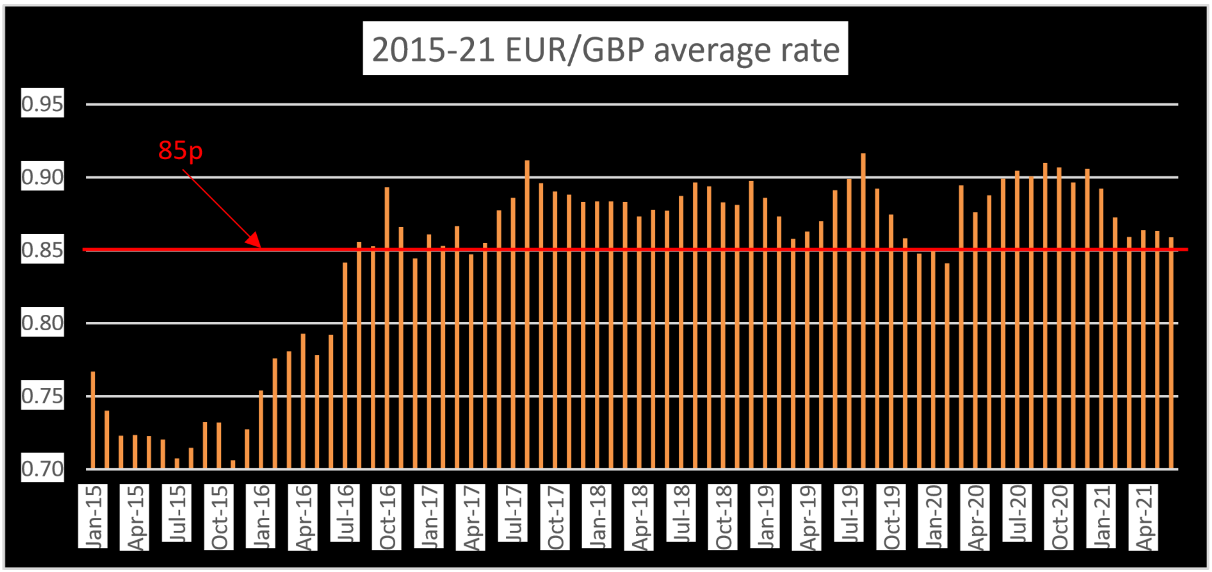
- **In fact, the post-Brexit vote average rate for the past 5 years has been EUR/GBP0.8783.**

- The conclusion would appear to be that any rate around or below EUR/GBP0.8500 is good value in that recent historic context.

- We will deal with inflation in more detail below, but the higher UK figures this week prompted a comment from Bank of England that higher interest rates may yet be appropriate. If this theme continues, (as we don't expect the same pressures in the Eurozone), expect to see EUR/GBP break down through 85p over the Summer.

Chart 1. EUR/GBP 2021 trend (Source: Refinitiv)

Chart 2. EUR/GBP monthly average rates: 2015-2021 (Source: Refinitiv)



KEY OBSERVATION

For now, GBP looks like it is going to hold in or around EUR/GBP0.8500. Short-term resistance level on the charts around EUR/GBP0.8490. This is a welcome relief for exporters. Importers may be forced to adjust prices upwards as the days of 90p look like a distant memory.

USD has bounced around in the past 9 months: which way from here?

Chart 3. EUR/USD: 5-year trend (Source: Refinitiv)

- Decided to revert back to the 5-year trend in EUR/USD just to put the current rate in that context.
- Stronger dollar trend prevailed from Q1 2018 to Q3 2020. In that period, the annual volatility (high to low) was also lower than in previous years.
- The 2020 weakening was material – monthly average went from EUR/USD1.0920 in May 2020 to EUR/USD1.2163 in December 2020 - but USD has bounced back strongly with the July to date average being EUR/USD1.1853.
- The rate has been supported by both very strong US economic data and ongoing speculation around inflationary pressures being permanent leading to interest rate hikes and or a reversal of the printing of money by the Fed.
- Exporters have benefited from the recent trend but it's too early to say if this will continue so remain alert for now.

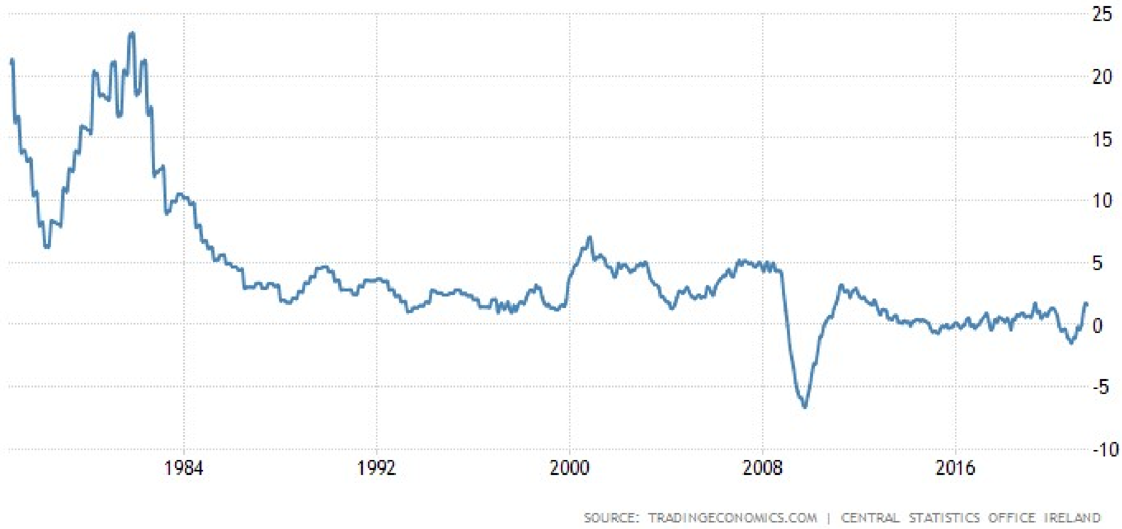
KEY OBSERVATION

The currency didn't really react positively to the increase in US interest rates in Q1, but it has strengthened against a backdrop of easing of rates in the past few weeks which is counterintuitive on the face of it. The amounts being spent by the Biden administration are huge and June inflation came in at +5.4%. For now, the Fed is of the opinion that this is temporary. If they are wrong, interest rates will rise and that will impact on the currency so USD buyers and sellers will have to watch and monitor this more closely over H2 2021.

Inflation: here to stay or here for now?

The chatter about inflation is whether it is just a temporary phenomenon or finally kicking in. The backdrop is a very benign inflationary environment for a long time. Chart 4 is Irish inflation since the early 80's and the last decade puts recent trends in a historic context.

Chart 4. Irish Inflation trends (Source: tradingeconomic.com)



In the UK, the June inflation rate just released was +2.5% which is above the Bank of England target. However, analysis of other data showed producer prices of manufacturers at +9.1% while factory gate prices were up just over 4%.

The big news was in the US over the past few days. Annual inflation rate to end June 2021 jumped to +5.4% (highest since August 2008). Largest increases were in used cars (+45.2%!) and gasoline (+45.1%). The debate as to whether such hikes are permanent or transitory continues to rage. The argument for the latter is that the big hikes are either attributable to a shortage of new cars (due to semiconductor shortages) or price rises off a low base for oil (Brent Crude dipped to $25 per barrel in March 2021 but currently sits around $75) and that they will wash through the system in due course.

Key Observation

In my opinion, the markets are a little too relaxed about the topic. Counterarguments around why it is transitory include the impact that technology will continue to have on keeping costs low and increasing productivity.

I think the geopolitical risk is understated and that will have an adverse impact (and on periodic bases) as events arise between countries. One of the summer readings is “The Power of Geography”. If you’re a nerd like me and it is holiday reading…worth investing some time!

The other variable is the impact of the high levels of liquidity from central banks. Is it different this time? One of the things (or both if we are unlucky) that is likely to arise over the next 12 months is either inflation kicks in as demand for products remains strong and governments also borrow large amounts and/or we will see the stock market/house price bubbles burst (and both appear to exist across many countries).

This has potential impact on GDP, interest rates and pensions/investment returns just for starters.

We would suggest keeping them to the forefront of your mind for the rest of the year…..but enjoy the Summer holidays in the interim!