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Weekly Report

# Weekly FX Market Update

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## Weekly US employment report dents dollar, puts Federal Reserve in a bind

The Federal Reserve cannot be happy with the US payroll report for August.

Weaker than expected employment growth shared the headlines with strong wage gains, suggesting that inflationary pressures will not be as transitory as it hopes. The US dollar promptly sold off even as US yields rose, a reversal of the usual correlation between the two. Risk assets put in a mixed performance last week. Commodities rose strongly to a fresh five-year high, pulling emerging market currencies with them, in a further sign that inflationary pressures are not abating. Equities had a rougher time, dragged down by the downbeat payroll report. The unambiguous loser of the week was the US dollar, down against nearly every major currency.

With the end of the holidays, focus now shifts to the major central bank meetings in September, led off by the ECB on Thursday and the Fed in a couple of weeks. The unusual stagflationary tone of the most recent macroeconomic news, particularly the US, makes it particularly hard to predict how policymakers will react. We expect at least some spirited debate within the ECB council, though it is not clear the consensus is there yet to start reducing the monthly PEPP purchases of sovereign bonds.

### CZK

The Czech koruna rallied against the euro last week, alongside its main regional peers, the Polish zloty and the Hungarian forint. Improved sentiment towards the EM currencies supported a decline in the EUR/CZK to its lowest level since mid-June.

Recent economic data from Czechia had been largely positive, with most readings surprising to the upside last week and at the beginning of this one. Second-quarter GDP data was revised upwards, from 0.6% to 1% quarter-on-quarter, while more current data from the industrial sector showed better-than-expected expansion in July. It's a welcome sign, particularly considering the sector's high importance to the Czech economy. The most current manufacturing PMI print showed a decline to 61.0, although it still indicates strong expansion in the sector.

The next few days will bring some additional first and second-tier readings, with Friday's inflation report for August likely grabbing the most attention as it could provide some cues regarding the pace of monetary policy tightening in Czechia.

## EUR

The flash inflation report in the Eurozone provided yet another disagreeable surprise. Headline and core components both rose strongly, and the increase can only partially be attributed to one-off factors. It seems clear that the ECB will face the same conundrum as the Federal Reserve: how to deal with persistent inflationary pressures even though labor markets have yet to return to pre-pandemic levels. This week's meeting will be finely balanced, and we expect at the very least to see the beginning of serious dissensions within the council, which could be supportive of the common currency.

## USD

The US payroll report carried a distinctly stagflationary odour, with a disappointingly low job-creation headline coupled with a strong gain in wages. While the latter would be welcome in general, we should note that these increases continue to lag most inflation measures and that in real terms we have seen so far wage reductions overall. As in the ECB's case, we continue to expect the debate within the Fed to intensify, as it becomes increasingly unclear whether additional monetary stimulus will do more good than harm in these circumstances. Regardless, the fall in the US dollar in spite of rising yields is more easily explained in a stagflationary context.

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