

OBSERVATIONS

- Last week's Mortgage Bankers Association survey showed that refinance activity fell again in August, this time by -1.1% on a month-over-month basis. Overall refinancing activity is the lowest since October 2000.¹
- Liz Truss becomes Britain's fourth Prime Minister in six years, inheriting an economy that is facing a currency (GBP) that has declined to the lowest level against the U.S. Dollar since 1985, while headline inflation has reached 10.1% on a year-over-year basis—the highest since 1982.²
- The Bank of Canada raised its benchmark policy interest rate by 75bps to 3.25%; similarly, the European Central Bank (ECB) also raised rates—which were previously at zero—by 75bps to 0.75%, amid slowing growth in Europe but the highest inflation readings in a generation.³
- The US ISM Service PMI increased in August to 56.9 from July's 56.7—any reading above 50 signals expansion—and showed that hiring in the service sector remained healthy and input prices softened modestly from earlier in the summer.¹
- The US trade deficit declined in July by \$10.2 billion from June as exports increased by 21% year-over-year (YoY) in July while imports increased by 16% YoY.⁴
- Queen Elizabeth II died last Thursday. In honor of her passing the Bank of England delayed its meeting this week until 22-September and the London Stock Exchange will likely be closed in the coming days due to a soon-to-be announced national holiday to allow for the Queen's funeral.⁵

EXPECTATIONS

- Russia announced last week that it would halt natural gas supplies to Europe through the key pipeline in response to Europe's war-related sanctions against the Russian economy.⁶ The announcement caused a new spike in natural gas prices and spurred new actions by European governments to blunt the price increases for consumers and businesses via consumer subsidies, price caps, and cheap lending to utilities.
- Newly elected UK PM, Liz Truss (see Observations) quickly unveiled a \$175 billion plan to cap the average household spending on natural gas and electricity to less than \$3,000 per year.⁷
- The Fed's late-August Beige Book, a qualitative discussion of economic conditions across the country, noted that economic conditions had changed little from their early-July assessment, with about half of Fed districts noting slight to modest growth, while the other half signaling slight to modest economic softening.⁸ As it noted in July, the August report reconfirmed that the residential housing sector was weakening across the country due to higher mortgage rates and noted that demand for office space had also weakened.

ONE MORE THOUGHT: *The US Dollar Strengthens to Historic Highs*⁹

The US dollar has been on a tear lately. The greenback has hit a nearly 25-year high against the Japanese Yen. It has reached parity with the Euro for the first time since mid-2002, and is at the highest levels against the British

¹ Bloomberg LP

² <https://www.ft.com/content/e24b9e99-fa7c-4145-b7aa-01f3594c33b3>

³ https://www.wsj.com/articles/ecb-raises-interest-rates-by-a-historic-0-75-point-as-europe-stares-at-recession-11662639573?mod=hp_lead_pos1

⁴ https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf

⁵ <https://www.theguardian.com>

⁶ https://www.wsj.com/articles/europe-girds-for-energy-market-turbulence-after-russian-gas-cut-11662323365?mod=hp_lead_pos2&mod=article_inline

⁷ <https://www.ft.com/content/984129f9-a133-468b-bc38-e8c4ec7386d6>

⁸ <https://www.federalreserve.gov/monetarypolicy/beigebook202209.htm>

⁹ https://www.wsj.com/articles/u-s-dollar-strength-lifts-americans-relative-spending-power-11662304836?mod=Searchresults_pos1&page=1

Pound since the mid-1980s. The dollar has strengthened more modestly against the Chinese Renminbi and the Canadian Loonie this year. The US Federal Reserve tracks the dollar against a basket of currencies which it weights on the basis of their importance for US trade—combining both imports and exports. By this index (see Chart of the Week), the US dollar is approaching its historic high set during the most acute days of the market sell-off during the onset of the Covid pandemic. The US dollar has been buoyed by the robust hiking by the Federal Reserve as well as the fact the US economy seems on stronger footing than either the economies of Europe or China. It is possible that the US dollar could weaken over the course of 2023 as the Fed winds up its hiking cycle and the economic prospects for China and Europe recover next year. But this broad, trade-weighted index goes back to the early 1970s and generally shows the gradual appreciation of the US dollar, which suggests that as more and more of the world develops and becomes richer, the demand for US dollars grows as well. The dollar strength this year has made it difficult for emerging markets as well as strained certain parts of the international financial system.

CHART OF THE WEEK

US\$ vs Fed Broad-Basket FX



Source: Clearstead, Bloomberg 2-Sep-2022

The Federal Reserve tracks a broad currency index daily of the US\$ against a basket of over 20 currencies weighted approximately by their volume of trade with the US.

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