Weekly Commentary 40

Whither the Dollar, the Yen and the Euro?

It is time to reexamine where the dollar is headed. For the past few weeks, the dollar has witnessed some weakness because there was news that the US economy has started to become weak, and that the Fed will need to lower interest rates. A few weeks later, the Fed has still not done so. Last night, at the start of the US trading session, the economic news came out mixed. On the one hand, there were 124,000 new jobs in the economy. Is that good? Not really, it was another data point indicating a worsening economy. But it was not as bad as expected.

So before the number came out, the dollar was weaker and after the figure, the dollar had a bounce. Here is what we observed in the FX markets:

The two charts above show the one year performance of, first, the dollar yen and then, the Euro against the dollar. It can be seen from the dollar yen chart that the recent correction from the highs of 161 is quite steep. And as of now, there has not been a correction back up. In the case of the Euro, there was the same steep fall but yesterday, there was a rebound which turned out to be quite strong. This may be short covering of short dollar positions and hence when the data from the latest unemployment figures came out, the Euro went back down. In other words, between the yen and the Euro, the latter is the weaker currency.

The long anticipated dedollarization has not happened, and the current market action is largely due to the outlook on relative yields. Even though the US economy is turning south, it is still doing better than most of the other G7 economies. Here is a summary of the US economic performance by the Wall Street Journal.

What Lies Behind the Markets' Jitters

Stocks and bonds are far more sensitive to economic indicators than they have been in the past—because investors are aware of just how much rests on a soft landing

By
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Markets are skittish. Tiny shifts in the economy are magnified into fear of recession or big relief rallies as sentiment swings wildly. Add in the deflation of some of the artificial-intelligence hype and recent stock moves frequently don't seem to make much sense.

Yet, under the surface two themes are emerging. We have entered a new market paradigm with a focus on economic growth, rather than inflation. Connected with that, previously unloved stocks have beaten the market's stars, helped by looming Federal Reserve rate cuts.

The big question for investors is whether these shifts will last.

"The market's trying to estimate the path forward and exploring the potential for a regime shift," says Sonja Laud, chief investment officer at Legal & General Investment Management. But, she says, "there's clearly still a majority expecting a soft landing, and the data is supportive of that."

The two new themes make a lot of sense. First, the change in focus to the health of the economy happened as inflation appeared to be under control while the jobs market weakened. The Fed has switched from worrying about too much growth to worrying about too little growth, and recession probabilities have picked up—albeit from very low levels.

"Six months ago we had a zero risk of recession," says Johanna Kyrklund, chief investment officer at Schroders. Now there is a risk, she says, that weakness among lower-income households starts to affect the rest of the economy.

The markets are far more sensitive to economic indicators than they have been in the past—because investors are aware of just how much rests on a soft landing.
This week, some slightly-weaker-than-expected manufacturing data led to another reassessment of the outlook, with stocks falling sharply and the 10-year Treasury yield dropping 0.08 percentage point. Moves of this scale in Treasurys have become common recently, but used to be reserved for major shocks; there was only one fall this big in the whole of 2018, for example.

The focus on economic weakness also shows up in a changed link between stocks and bonds. When the market focused on inflation, good news on the economy was generally bad news for stocks because it meant upward pressure on prices and higher interest rates from the Fed.

Now good news on the economy is good for stocks, because it relieves concern about growth, and rate cuts are expected anyway. The opposite also holds: Bad news on the economy is now bad for stocks.

As a result, the link between the S&P 500 and 10-year Treasury yields that held for a year has reversed. Stocks and bond yields have a slight tendency to rise and fall together, rather than moving in opposite directions, as they did previously.

Falling yields are part of the reason for the recovery in unloved stocks, the second theme. Since the Juneteenth holiday, when AI superstar Nvidia hit its last high, cheap "value" stocks have done far better than growth stocks. The Russell 1000 value index is up 5%, while its growth version is down 4%—although that has only partially

reversed the stunning gains for growth earlier in the year. The average S&P stock has also handily beaten the index, after lagging far behind in the first half of the year.

The reverse also held for the best- and worst-performing sectors. Technology and communication services went from best to worst, while highly leveraged real estate went from worst to best thanks to falling Treasury yields.

However, the market's story isn't perfect. Banks did well in both periods, helped by the steeper yield curve as longer-dated bond yields fell less than shorter dated (the 10-year yield was briefly above the 2-year on Wednesday for the first time in two years). Utilities were helped by lower yields, but were boosted all year by a boom in electricity demand for AI processing. And boring consumer-staples stocks that are meant to do well in a weak economy beat the more-exciting consumer-discretionary sector in both periods.

Smaller companies are also failing to match the theme. They haven't benefited from lower bond yields, even though they carry more debt. There has also been little difference in the performance of small growth and small value.

My guess is that the market will continue to be supersensitive to signs of economic weakness, even after the Fed starts cutting rates, as recession will remain a risk for a good while yet. I'm less sure about the return of value stocks. Aside from anything else, for more than a decade now, no value rebound has been sustained.

The Financial Times has this to add:

US stocks turn in worst week in 18 months over slowdown fears
Soft payroll data prompts traders to increase bets on aggressive rate cuts by Federal Reserve Investors are looking for signs that the US economy has cooled faster than anticipated

US stocks suffered their worst week in more than a year, as weak economic data and cautious commentary from central bankers stoked investor concerns over a possible economic slowdown.

Wall Street's benchmark S&P 500 dropped 1.7 per cent on Friday, bringing its loss for the week to 4.2 per cent — its worst weekly drop since March 2023. Large tech stocks were particularly badly hit, and the tech-dominated Nasdaq Composite had its sharpest weekly fall since January 2022, dropping 5.8 per cent, including a 2.6 per cent fall on Friday.

The latest declines followed weaker than expected payroll data on Friday morning. US employers added 142,000 jobs in August, below a consensus of analysts' forecasts of 160,000, although it was above the downwardly revised 89,000 jobs created in July.

However, the unemployment rate dropped to 4.2 per cent.

Top Federal Reserve officials added to the cautious mood with comments that left the door open to half-point interest cuts. Fed governor Christopher Waller and John Williams, president of the New York Fed, endorsed a series of rate cuts this year given the fall in inflation and softening of the labour market.

The yield on the interest rate-sensitive two-year Treasury bond fell 0.09 percentage points to 3.66 per cent, while the yield on the benchmark 10-year fell 0.01 percentage points to 3.72 per cent. Yields move inversely to prices.

The dollar index, which tracks the US currency against a basket of other currencies, turned higher, up 0.1 per cent, having initially fallen after the data. The yen hit ¥142.4, its highest level since January.

Futures markets indicated on Friday that traders had reduced their bets on the probability of a 50-basis point cut following the payrolls report, but expectations were fluctuating widely. Swaps markets were pricing in close to four and a half quarter-point cuts by the end of the year, slightly more than prior to the data.

Fed chair Jay Powell said last month he was focused on the risks of a weaker labour market. He cautioned that the timing and pace of rate cuts were reliant on economic data.

Stock markets in Europe were also volatile after the jobs report. The Stoxx Europe 600 finished 1.1 per cent lower, as did the Cac 40 in Paris. The FTSE 100 in London dropped 0.7 per cent and the Dax in Germany closed down 1.5 per cent. Japan's Topix closed 0.9 per cent lower on Friday, while South Korea's Kospi was down 1.2 cent and China's CSI 300 index fell 0.8 per cent.

"The risk appetite is rather concentrated in US data . . . given the sagginess of Chinese growth," said Trinh Nguyen, senior economist for Emerging Asia at Natixis in Hong Kong. "Markets will need reassurance of a not too slow US economy but at the same time weak enough for the Fed to not fear [an] inflation resurgence."

Crude oil futures gave up early gains to hit their lowest levels of the year, even after Opec+ members agreed late on Thursday to delay planned production increases for at least two months. Brent, the international benchmark, lost 2.5 per cent to $70.90 while West Texas Intermediate, its US counterpart, fell 2.6 per cent, to $67.37.
FirstFT Americas, every weekday

Shift in US bond yields leaves investors guessing about economic outlook
Yield on two-year Treasury falls below 10-year counterpart as inversion in closely watched indicator ends Swaps markets are fully expecting a quarter point interest rate cut from their current range of 5.25 to 5.5 per cent at the Fed's meeting later this month

Valerie Plesch/Bloomberg Jennifer Hughes and Harriet Clarfelt in New York and Laurence Fletcher in London YESTERDAY

Short-term US government borrowing costs have fallen below long-term costs in a reversal of the so-called “inverted yield curve”, a move that some analysts believe could herald an imminent economic downturn.

The yield on the rate-sensitive two-year Treasury fell below that of its 10-year counterpart on Thursday, after data showed the US private sector added the fewest jobs in three and a half years in August.

Bond yields move inversely to prices. An inverted yield curve — when long-term yields are lower than short-term ones — has historically been seen by some investors as an indicator of a recession, even though it has not always proved accurate.

The bond market has been sending this signal almost continuously for the past two years. However, investors and strategists are split on what the ending of this inversion — driven by investors increasing their bets on rapid interest rate cuts in recent weeks — might mean.

While some speculate it could mean better news about the economy, others say it may mean the precise opposite — that a downturn is now imminent. “It’s tempting to suggest we can sound the all-clear” on the economy but “we’re not out of the woods yet”, said Deutsche Bank strategist Jim Reid. He said that recessions tend to start when the yield curve moves away from being inverted. “Indeed, the last four recessions only began once the curve was positive again,” he said.

However James Reilly, an economist at Capital Economics, said that while the spread disinverting “has tended to precede recessions in the past . . . this move in yields is a symptom of investors’ worries rather than a new cause for alarm.”

“The Treasury yield curve has steepened in recent weeks amid growing recession concerns, but we doubt one will materialise this time,” he said. Short-term yields are, historically, usually below longer-term ones, reflecting the higher risks of lending over longer time periods. When short-term loans cost more than long-term ones, it implies investors expect growth — and therefore interest rates — will be lower in the years to come.

Swaps markets are fully expecting a quarter point interest rate cut from their current range of 5.25 to 5.5 per cent at the Fed’s meeting later this month, and additionally are pricing in a 40 per cent chance of a half point cut. They expect just over one percentage point worth of cuts by the end of December.

Labour market data on Wednesday showed that US job openings came in lower than expected for July, triggering the latest sharp rally in short-dated government bonds.

The Job Openings and Labor Turnover figures showed that US job openings fell to 7.7mn in July, its lowest level in three years and lower than economists expected. The yield on the two-year Treasury note briefly slipped below the 10-year yield's level on Wednesday before hovering in a tight range just above the "inversion" threshold, as investors expected the figures would keep the Fed on track to lower rates this month.

"At the margin, the JOLTs data does matter," said Ajay Rajadhyaksha, global chair of research at Barclays. "[The Fed] takes it seriously; they will not shrug it off. The market knows that, and that is why you got that brief un-inversion."

This is "not so much about the yield curve", he added "as it is about the front-end rally in anticipation of a quicker cutting cycle".

Cementing investors' expectations of looser monetary policy, Fed chair Jay Powell signalled at August's Jackson Hole economic conference that "the time has come" for US interest rate cuts.

He said at the symposium that "downside risks" to the labour market had increased.

The Fed needs to avoid becoming passive aggressive

The yield curve had already briefly un-inverted early last month, after a much weaker-than-anticipated July payrolls report sparked fears of a looming recession and drove investors to bet on rapid and deep interest rate cuts.
Those concerns were later soothed by a flurry of stronger economic reports, but market participants are watching each data point closely for clues about the future path of US borrowing costs.

Friday will bring the latest non-farm payrolls report, with economists expecting US employers to have added 160,000 jobs in August, according to a Reuters poll — considerably higher than the previous month's figure of 114,000.

"We think that the front-end might have rallied a bit too far," Skiba added. "We've struggled to see how the Fed cuts more than [one percentage point] here in the absence of economic data getting much worse — but clearly that is where the debate from the market perspective is at this stage."

Of course, whether the dollar goes up or down depends not just on the US, but also on Japan and Europe, notably Germany. Both regions are not doing exactly great, as is revealed in the following analyses.– The first is from Deloitte on Japan:

After a solid rebound in economic activity in the first half of 2023, Japan's economy has since struggled. Real gross domestic product fell 0.5% in the first quarter of 2024 from the previous quarter and was down 1.3% from its peak in the second quarter of 2023.[1] Much of this weakness is coming from consumers: Domestic household spending fell in three of the last four quarters. Residential and nonresidential investment and exports, all fell in the first quarter of 2024.

Fortunately, the economy appears to be at an inflection point. We anticipate that real GDP growth will begin to recover in the second half of 2024. Stronger wage growth and more moderate inflation are expected to boost consumer spending. Plus, a weak currency is likely to drive export growth. While these factors should collectively improve economic conditions, we expect growth will be relatively modest. The central bank is expected to tighten monetary policy, limiting some of the upside to growth.

Consumers poised for a rebound

Most indicators of consumer spending remain weak, but there is evidence of a turnaround. Real household spending in May was down 1.8% from a year earlier, but this is a considerable improvement from the 6.3% year-over-year decline in January.[2] In May, retail sales growth accelerated. But other measures of consumer spending, such as the real consumer activity index, have yet to show signs of acceleration.[3] Nevertheless, consumer fundamentals have clearly changed for the better, which should usher in stronger consumer spending in the coming months. Part of the improvement comes from the labor market. In establishments with five or more employees, scheduled earnings—a measure of wages that excludes overtime and bonuses—rose 4.7% from a year earlier in May,[4] the fastest pace of wage growth since 1992 (figure 1). And with wage growth outpacing inflation, which stood at just 2.8% in May, compared to a year earlier,[5] households have greater purchasing power. Meanwhile, unemployment has remained very low, at 2.6% in May,[6] and total employment continues to grow.[7]

Meanwhile, rising food and energy prices pose one challenge to consumers. Fuel, light, and water charges were up 6.6% from a year ago in May, reversing a trend of annual declines since February 2023. Food prices were up 4.1% from a year ago and grew at an annualized 5.3% over the prior three months.[8] The recent rebound in these prices has likely weighed on consumer sentiment and discretionary spending: The consumer confidence index fell 3.3 points over the prior two months,[9] and real household spending on culture and recreation declined 9.6% from a year ago.

A weakening yen is partly responsible for the rise in food and energy prices. For example, the import price index in yen terms was 6.9% higher than a year ago in May.[10] The yen has also continued to weaken despite market participants expecting the Bank of Japan (BoJ) to tighten monetary policy, which typically results in an appreciation of the yen. On June 27, 2024, the yen briefly hit 160.82 against the US dollar, its weakest level since 1986,[11] raising expectations that the government might step in to defend the currency against further depreciation.

The yen continues to tumble

If the government intervenes, its efforts are unlikely to have a lasting shielding effect on the yen. Still, the intervention could buy policymakers some time to enable conditions necessary for the appreciation of the yen to materialize. In the United States, the Federal Reserve is expected to begin cutting rates this year, which will likely lower the spread between US dollar–denominated bonds and yen-denominated ones, thereby weakening the US dollar and strengthening the yen.

At the same time, Japan's central bank is expected to tighten monetary policy further, though the extent of tightening remains highly uncertain. The BoJ has said it will start reducing its bond purchases[12]—which would tighten monetary conditions—after hearing from market participants. In its June summary of opinions, the BoJ signaled that it would raise rates soon even if inflation has not rebounded.[13]

Part of the confusion around Japanese monetary policy is the fact that underlying inflation looks benign in the country. For example, western core inflation, excluding food and energy, was just 1.6% on a year-ago basis in May and was flat month on month since (figure 2).[14]

Notably, services inflation was just 1.5% in May, compared to a year ago, down from its cyclical peak of 2.3% in November.[15] Such conditions would normally signal the central bank to ease monetary policy rather than tighten it.

The BoJ may tighten policy largely because the labor market is now strong enough to create more inflationary conditions: For example, wage growth is running around 4% a year, while productivity growth in the services sector has been negative for three of the last four years. This suggests that most of that wage growth will be passed on to consumers in the form of higher prices for services. The BoJ is also feeling the pressure to tighten since a weaker yen adds to the risk of higher inflation as it causes import prices to rise.

Exports grind higher

The silver lining of a weak yen is that it has driven demand for Japanese goods and services. The number of foreign visitors reached a record high in March and was 60.1% higher in May compared to a year earlier.[16] This comes despite the fact that the number of visitors from China was still firmly below where it had been before the pandemic. Foreign tourism has helped boost related employment. For example, employment in accommodation, eating, and drinking services was up 3.4% from a year earlier in May, making it one of the strongest industries in terms of employment growth.[17]

Foreign demand is not limited to tourist services either. Goods exports have accelerated and were up 11.9% from a year earlier in May.[18] A weak yen is part of the reason exports are growing so quickly, but so is the global competition for technology. Tellingly, integrated circuits exports were up 32.2% from a year ago in May.[19] Transportation equipment and chemicals also grew by double-digit rates. Such strong demand for Japanese goods and services can also increase inflation as capacity constraints are tested.

Although an inflation rebound is yet to materialize, the signs of it remain too strong for the BoJ to ignore. Wage growth, in particular, is signaling that inflation will potentially move higher and that consumer spending will likely pick up soon. As the BoJ begins to tighten, the yen should stabilize or even appreciate, which will reduce the cost of food and energy, giving consumers an additional boost to their spending

power. While a stronger yen may ultimately hurt Japanese goods and services exports, the yen is expected to remain weak by historical standards, which should allow ample foreign demand to persist.

The economy in Germany is also not doing well. This is a self inflicted wound, given they imposed economic sanctions on their most important energy provider, Russia, since 2022. This is from an analytical piece from the European Commission:

15 May 2024
Economic forecast for Germany

The latest macroeconomic forecast for Germany.
Spring 2024 Economic Forecast: A gradual expansion amid high geopolitical risks

Following a recession in 2023, economic activity in Germany is expected to stagnate in 2024. Domestic demand is set to pick up slowly in 2024 and 2025, as real wage growth resumes. However, investment is projected to remain well below pre-pandemic levels, constrained by continued high financing costs. Exports are forecast to remain sluggish in 2024 and slowly recover in 2025. Driven by domestic demand, GDP growth is expected to increase moderately in 2025. Fiscal consolidation continues with the government deficit and the debt-to-GDP ratio gradually decreasing, benefitting from the phase-out of energy support measures.

The German economy went through a recession in 2023 when real GDP declined by 0.2% (according to the latest GDP release by the German Federal Statistical Office).

Despite continued headwinds, it recovered slightly at the start of 2024, with economic activity expected at 0.2% qoq in the first quarter of 2024. Purchasing power recovered significantly during the previous year but private consumption remained sluggish during 2023. Investment is still expected to contribute negatively to economic growth in 2024. At the same time, weak foreign demand for capital and intermediate goods is affecting German exports. Overall, real GDP growth is forecast to increase by 0.1% in 2024.

With an expected further easing of inflation, real household income is set to continue to recover. Combined with improved consumer sentiment, private consumption is projected to return to pre-pandemic levels in 2025. After a strong decline in investment activity during the previous years, recovery in investment growth is expected in 2025, also thanks to the assumed improvement of financing conditions.

At the same time, the persistently high housing demand is expected to support a recovery in construction as from the second half of 2024. Trade is not projected to support growth in 2024 and it is set to have only a minor positive contribution in 2025. The main reasons behind this are a loss of competitiveness in some (mainly energy intensive) sectors. Overall, real GDP growth is forecast to recover moderately to 1.0% in 2025.

Labour market to remain stable

In 2023, a record-high 83.6% of the population aged 20-64 was active on the labour market, up from 83.3% a year before. The resilience of the labour market is also reflected in the unemployment rate, which is expected to remain broadly stable at around 3.0% over the forecast horizon. The job vacancy rate has been somewhat receding given the softening of economic activity, but it remains at high levels, and the acceleration of ageing will continue to weigh on labour supply and tightness of the labour market. In 2023, real wages turned a corner and grew significantly, after several quarters of real wage losses. Real wages are set to continue their recovery in 2024 and 2025, in a context of higher nominal wage outcomes and lower inflation.

Inflation to ease further

Inflation has decelerated steadily since October 2022 on the back of the decline in wholesale energy prices and the introduction of measures to mitigate the impact of high energy prices. However, the phase-out of these measures and higher fuel costs are expected to contribute positively to overall inflation in 2024 and 2025. The decrease in inflation is also set to be slowed down by continued wage growth, which is expected to sustain price pressures in services. Overall, inflation is projected to ease to 2.4% in 2024 and 2.0% in 2025, down from 6.0% in 2023.

Public finances on a path of consolidation

In 2023, the general government deficit remained at 2.5% of GDP. The gas and electricity price brakes replaced a variety of earlier energy-related measures, while the increase in the long-term care contribution rate helped to compensate income tax cuts due to tax bracket adjustments and increases in tax allowances for children. With the "debt brake" back in force as from 2024, the spending possibilities of the government will be more limited in the years to come.

In 2024, the government deficit is expected to decrease to 1.6% of GDP, as a result of the phase-out of measures to mitigate the impact of high energy prices dropping from 1.2% of GDP in 2023 to 0.1% of GDP, and of a robust development of government revenue. Solid tax revenue and strongly increasing social contributions, due to rising salaries and social contribution rates, are expected to more than outweigh income tax reductions and the increase in child allowances.

In 2025, based on unchanged policies, the general government deficit is projected to further decrease to 1.2% of GDP. On the revenue side, social contributions are set to benefit from the phase-out of the inflation compensation bonus that allowed employers to pay a tax-free and social contribution-free bonus of up to EUR 3.000 in total during the period end 2022 to end 2024. On the expenditure side, robust growth is set to continue as pension payments and public sector wages are projected to increase noticeably.

The government debt level dropped to 63.6% of GDP in 2023. It is expected to slowly decrease over the forecast horizon, to 62.9% and 62.2% in 2024 and 2025 respectively, due to inflation and the reduced debt increasing impact of primary deficits. The introduction in 2024 of a capital-based element to the pension system

will increase the gross debt ratio by around 0.3 pps. every year going forward, without impacting the government deficit, as the yearly contributions to this investment fund constitute financial transactions.

Germany is also facing serious political problems. As reviewed by the Financial Times:

The German far right and the scars of reunification *More than three decades after the end of communist rule, the victory of the AfD in a state election in the east underlines a lingering political divide*
15 HOURS AGO

Earlier this year, Germany was roiled by reports that politicians from the far-right Alternative for Germany had hatched plans to expel hundreds of thousands of people with immigrant roots, including some with German passports, as part of a policy it euphemistically called "remigration". The revelations triggered mass protests in dozens of German cities against the rise of the right.

Many in Berlin believed the reports would finish off the AfD. In eastern Germany, they only boosted its popularity. The proof came last Sunday with two regional elections that unleashed a political earthquake in Berlin.

The AfD won in Thuringia, marking the first time in postwar German history that a far-right party had secured victory in a state election. In neighbouring Saxony they came a close second, just behind the centre-right Christian Democrats (CDU).

It was a triumph for the AfD's leader in Thuringia, Björn Höcke, an ethno-nationalist ideologue who was fined €30,000 this year for using banned Nazi slogans. "Germany can't just go back to business as usual after this," he said after the results were announced.

Voters were sending a message about immigration. "If we don't get it under control the state will just collapse," he added.

The AfD left the three parties in chancellor Olaf Scholz's fractious coalition in the dust. Voters seemed to be punishing a deeply unpopular government that they blame for everything from high inflation and uncontrolled immigration to expensive climate policies and constant internal bickering.

In an era where populist parties of the right and left are on the advance across Europe, the AfD's successes might seem like another protest by voters who feel left behind. In the German case, the results speak more of the lingering political divide in the country more than three decades after the fall of communist rule and reunification.

Sunday's result suggests that divide is becoming deeper — and more permanent. Eastern Germany has actually fared relatively well economically over the past decade.

But the turmoil of the early years of reunification has left many easterners feeling deep resentment towards the political establishment, which makes them more sympathetic to parties that oppose liberal democracy and are determined to undermine it.

For many analysts, the biggest surprise about the results was that the AfD performed so well despite its growing radicalism. While the AfD initially dismissed the reports about its deportation plans as a smear campaign, it has more recently fully embraced the concept of remigration.

In the east German campaign it was one of its main selling points. That was evident at a rally in the Thuringian town of Suhl a couple of weeks before the election where Carolin Lichtenheld, an AfD activist in her early twenties, went on stage to demand the mass deportation of immigrants "here and now".

"We don't want a 'multiculti' society — we want to save Germany," she said, to cheers from the crowd, which joined her in chants of "Re-, re-, remigration!"

AfD youth activist Carolin Lichtenheld demanded the mass deportation of immigrants 'here and now' during a party rally in Thuringia before the election © Heiko Rebsch/picture-alliance/dpa/AP Images In other parts of east Germany, AfD posters abounded with pictures of airliners in flight and the slogan: "Summer, sunshine, remigration!" while activists at AfD rallies handed out balloons in the shape of "deportation planes".

The AfD was not the sole beneficiary of voter discontent in the east. A new populist party led by Sahra Wagenknecht, a former communist and best-selling critic of capitalism, also did well. Like the AfD, her party, the BSW, demands strict curbs on immigration, an end to military support for Kyiv and peace talks to stop the Ukraine war.

That nearly 50 per cent of voters in Thuringia — and 42 per cent in Saxony — had voted for populist parties of the left and right immediately triggered a wave of angst-filled soul-searching in Berlin.

Ever since, many have been asking why east Germans' voting behaviour is so different from that of their western compatriots. The historian Ilko-Sascha Kowalczuk, himself an Ossi or east German, says it's "no coincidence" that both Höcke's and Wagenknecht's parties were so sympathetic to "Vladimir Putin's bloodthirsty dictatorship in Moscow".

"That goes down well in east Germany because such authoritarian ideas are very widespread there," he told ZDF TV. "The call for a strong state has never really gone away there since 1990."

The results were a painful wake-up call for a German political class that has tended to see the fall of the Berlin Wall and reunification — a period Germans call the Wende — as one of the few unadulterated bright spots in the country's troubled, at times tragic, history.

"It really hurts," said Wolfgang Thierse, an easterner who rose to become one of the most prominent Social Democrats in post-Wende Germany. "It feels like a personal defeat." Björn Höcke at a rally in front of a banner saying 'The East does it'.

The AfD leader in Thuringia says Germany can't go back to business as usual after the state election results © Clemens Bilan/EPA-EFE/Shutterstock Speaking on German radio, Thierse said that during trips this spring to Thuringia — the region he grew up in — he was shocked at the scale of "hatred and contempt for democrats and democratic institutions" he encountered there.

There was something profoundly puzzling about it. "All this doom and gloom — they tell you everything's bad," he said. "But then you ask people about their personal situation, and they say 'for me personally things are going well'." Therein lies one of the biggest mysteries of last Sunday's election.

In recent years, at least, the eastern economy has actually been relatively strong. That is the assessment, anyway, of Oliver Holtemöller of the Halle Institute for Economic Research, who notes how "successfully it has caught up" over the past 20-30 years. "The productivity of the eastern economy was just 30 per cent of that of the west in 1990, but now it's about 80 per cent," he says. "Such progress would not have been possible anywhere else in such a short period."

The region's economy has also outperformed that of western Germany over the past two to three years, he adds, partly thanks to a large public sector less vulnerable to cyclical fluctuations, as well as pension increases that disproportionately benefited easterners.

Scholz also seems mystified. Asked at a town-hall meeting earlier this week about the election results, he said that "compared with all the other countries on the other side of the Iron Curtain, eastern Germany has done really well". Look at the billions in investments pouring into spanking new semiconductor plants in Saxony and Tesla's gigafactory in Brandenburg, he added.

But he acknowledged that wages were still lower in the east. "That's something a lot of people can't understand, and neither can I," he said. "We need a really big push [to plug the gap]."

Yet such upbeat assessments of the east's progress mask a more complex reality. The post-Wende years were not a time of unalloyed joy for the easterners, but instead a period of upheaval and crises that left their mark not only on the generation that came of age in communist East Germany, but on their children and grandchildren.

For Detlef Pollack, a sociologist at the University of Münster who researches the history of East Germany, the period of the Wende "left wounds that have still not healed". "The trauma of the 1990s continues to reverberate up till today and [the east Germans] have basically never got over it," he wrote in the Frankfurter Allgemeine Zeitung last month.

"For many, the Wende meant economic collapse, loss of status, unemployment," says Benjamin Höhne, an expert in populism at Chemnitz Technical University and native of the east German town of Wittenberg.

The legacy of that turmoil fuelled a sense of grievance towards Besserwessis, the smart-Alec westerners, which lingers to this day. In exit polls by Infratest dimap in Thuringia, 75 per cent of respondents said that east Germans were still second-class citizens. Seventy-eight per cent said the culture and mentality of east and west remained "different".

Politics and business were "still too strongly determined by west Germans", another 75 per cent said. BSW leader Sahra Wagenknecht and top candidate Katja Wolf celebrate after exit polls in Thuringia showed the party in third place

Demographic shifts have played a key role in shaping political sentiment. Thuringia's population fell by about 500,000 after 1990 to 2.1mn now, creating a downward spiral that continues to play out, particularly in rural areas. Katja Wolf, the BSW's lead candidate in the Thuringian elections who was born and brought up in the GDR, describes how the quality of rural life declined as people moved away, both to cities in the east and to the west. First to close, she says, was the village shop, then its GP practice, then the bank, then the youth club, and finally the local school.

"The promise was that [after reunification] you'd be better off than you were, and in purely material terms they were right," she says. "But in rural areas you see a history of loss." Older people have to travel much further for doctors' appointments than they used to, yet bus services have been savagely cut. They have also had to contend with soaring heating costs "on an average monthly pension of just €1,200".

"The villagers feel left behind and their view is [it's] because all the money is going towards integrating immigrants," she says. "The feeling is, there's nothing left for us, not even a bus."

Experts say the more depopulated an area is, the higher the support for the AfD. In some Thuringian villages, more than half the population voted for the far-right party last Sunday. But it is not just the slow decline of rural areas that has stoked the rise of the populists on the right and left. Experts also identify the refugee crisis of 2015-16, in which Germany admitted more than 1mn migrants, and the Covid-19 lockdowns, which provoked much more social unrest in the east than the west.

In the first instance, easterners felt the government had lost control: in the second, that it was doing too much. "They felt during the pandemic that the state encroached

on their rights," says Mario Voigt, Christian Democrat leader in Thuringia. The University of Münster's Pollack says the AfD's popularity grew from a sense that progressive social values supported by government are at odds with their own.

They feel the government now expects them to welcome immigration, accept sexual diversity and alternative lifestyles and keep their national pride in check. AfD protesters with a banner reading 'Remigration Now'. The party's popularity in east Germany has grown from a sense that progressive social values supported by government are at odds with their own

"A mood of protest and outrage, of grievance and discontent, of humiliation and rebellion has emerged in the east which rejects all attempts at dialogue, communication and enlightenment," he wrote. Some observers warn against exaggerating the significance of last Sunday's election results.

Populist parties of the right and left have long been strong in countries like France and the Netherlands, they note. "East Germany is reverting to the European norm," says populism expert Höhne. Western Germany, where big-tent, centrist parties like the CDU still dominate, "is rather the exception".

Indeed, some expect a greater convergence between east and west Germany in the coming years. Voigt of the CDU says it is already happening: he points to the AfD's strong performance in recent regional elections in west Germany, such as in Hesse last October, where it came second. "The East is not an anomaly," he says. "On the contrary, it's like looking into the crystal ball, it shows what's ahead for all of us."

As we can see from the charts against the two most important counterparts to the US Dollar, the Yen is now showing signs that it will be stronger than the Euro. The Euro suffers from another problem – the collapsing Ukrainian war in favour of Russia. This has long been predicted by the many military and intelligence experts that I follow. And it has finally come to pass. In the last week, there was a major reshuffle of Ukraine's cabinet. The country is in deep trouble. And they are finally admitting it.

The attempt of an incursion into the Kursk region of Russia was a very bad strategic error. They underestimated the Russians, thinking that they would redeploy troops to defend home turf. They were tragically wrong. The Russians did not fluster. They took the hit to prestige and did not react until they brought in additional forces, from elsewhere, to contain the threat. Once they got the Ukrainian forces surrounded, it was a matter of taking the time to wipe them out. After one month, the Ukrainian brigades that got entangled in Kursk have been decimated. When they were actually needed on the Donbass front further south. And because the Ukrainians moved their best soldiers to try to attack Russia in the rear, they could not have enough manpower to defend themselves in critical areas which they have should have defended. It was just bad strategy. And guess who came up with the big idea? The clown, Zelenskyy.

All said, NATO is now in big trouble. There is dissension among the members on continuing support for Ukraine. As noted in the article from the FT about Germany, the ordinary men in the street are not with the political class. The political class seems isolated in their support of Kyiv and in following American foreign policy by the book. With the economic counterpart of NATO, the EU, not doing well, which was a self imposed liability because of the sanctions, Europe will limp from here onwards. The FX markets are reading the same signals, and the Euro is not doing well relative to the Yen.

The drop from the dollar high on the Euro since the Dollar Yen was at the high at 161 2.5 percent. The collapse of the Dollar Yen from its high was 13.5 percent (which means that the dollar is getting weaker against the Yen). So for the moment, the Yen is stronger than the Euro.

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Un-Influencer in a World full of Hubris

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