FX Daily: Looking for potential winners from USD stabilisation

The dollar stayed gently offered as the market processed the more cautious tone from Powell on Friday. We expect currencies backed by hawkish central banks to be the winners in a more stable USD environment. This means that the ultra-dovish ECB (despite rising EZ inflation) should limit the EUR upside and policy divergence may pressure AUD/NZD further

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USD: Might struggle to recover before Friday's NFP

It appears that the market's key take-aways from Friday's Jackson Hole speech by Fed Chair Powell were: (a) tapering by year-end remains on the cards; and (b) there is an urge at the FOMC to de-link tapering and tightening. Considering that the first point had been largely priced in, it was the second one that effectively drove the market reaction, and ultimately weighed on the dollar given the uncertainty around a 2022 rate hike (which, however, remains part of our economist's forecasts).

At this stage, it appears that a September tapering announcement will highly depend on this week's US jobs data. Another strong number should give some support to the dollar which has otherwise remained broadly offered since the start of this week. At the same time, it appears that a somewhat more cautious tone by Powell compared to the recent Fedspeak – and in particular the notion that tightening will not automatically follow tapering – is set to keep front-end yields anchored for longer and potentially leave room for some bearish curve steepening. Generally, this is an environment that favours high-beta currencies and should put a curb to any resurgence of strong bullish sentiment on the dollar. At the same time, the spread of the Delta-variant (which this week has caused the EU to reimpose travel bans on US travellers, and has kept weighing on China's data-flow) continues to take a toll on the global growth outlook, which coincidentally makes any extended downward trend in the safe-haven dollar across the board as unlikely for now.

We remain of the view that any dollar stabilisation should see those currencies backed by hawkish central banks - NZD, NOK, CAD in G10; BRL, RUB and possibly MXN in EM – emerge as key outperformers. These days leading to Friday's US payrolls, as the dollar may struggle to recover just yet, could provide a benchmark in this sense. For now, NOK, NZD (on which we elaborate in the section below), BRL and MXN have all started the week on the front foot. Looking at the commodity FX segment, there is some potential for extra support coming the oil-sensitive currencies' way if Hurricane Ida's disruptions to the Gulf's oil production chain drive crude prices higher. So far, the impact has been quite contained, not a big surprise considering that Delta-variant concerns keep clouding the demand side and also the fact that oil production in the Gulf now represents a smaller portion of global output.

The US data calendar should not interfere with other market drivers today, as some housing figures along with the Conference Board Consumer Confidence and MNI Chicago PMIs should not have any material market impact.

EUR: No impact from rising inflation

German CPI data released yesterday were in line with market consensus, showing a marginal acceleration in annual inflation from 3.8% to 3.9% in August. The aggregate figures for the eurozone will be published later today, and even though we will indeed see another acceleration in inflation, the unreactiveness of the ECB – especially after having turned structurally more dovish with the strategy review – means that the EUR is unlikely to be impacted.

In our view, the ultra-dovish ECB also means that the EUR should have more contained upside potential compared to those currencies backed by tapering/tightening if indeed the dollar is set to stay gently offered. We could see the EUR/USD rally starting to lose some steam around the 1.1850 level.

UK: Domestic drivers stay on holiday

The complete absence of domestic drivers in the UK due to a very light data calendar (also, yesterday was a national holiday in the UK) and no Bank of England speakers have made Cable merely piggyback EUR/USD's modest uptick so far this week. A break above 1.3800 this week should, if anything, be driven solely by USD weakness, while EUR/GBP looks likely to keep trading within its recent narrow range for now.

Antipodeans: China's slowdown a risk for both, but NZD looking better than AUD

Official PMIs for August released in China overnight have augmented concerns about the negative impact of the Delta-variant on the country's economy. The service gauge dropped the most, moving to sub-50 levels for the first time since 2020. This has not seemed to particularly bother the Asia FX segment (which is enjoying a broad recovery) while USD/CNY has flattened around the 6.4650/6.4700, but Chinese equities have come under pressure again.

In G10, the deteriorating growth outlook in China remains a key risk to the ability of AUD and NZD to fully benefit from a further recovery in high-beta currencies. AUD, however, is generally more exposed than NZD given the higher percentage of exports heading to China and the strict relationship between China's growth sentiment and iron ore prices – which remain at risk of more downside corrections despite some signs of stabilisation in the past few days.

Incidentally, NZD is more attractive than AUD considering the monetary policy outlook, as the RBNZ should start tightening in October (which is, by the way, not fully priced in yet) while the RBA might actually pause its tapering plans due to the worsening contagion picture. AUD/NZD broke below 1.0400 overnight, and we think there is room for a move to 1.0300 in the near term.

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