FX Daily: A tentative risk stabilisation ahead of intense central bank activity

Equities are showing tentative signs of stabilisation this morning, but Evergrande's situation remains highly volatile, and markets may be enjoying only a short-lived respite before China's markets reopen tomorrow. The Riksbank may kick off a week of central bank meetings by dodging hawkish hints, and Trudeau's minority win may keep CAD capped for now

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USD: Can the risk stabilisation last?

It's a week full of central bank meetings, six only in G10: here we summarise what we expect to hear from each of them, and what may be the FX implications. For now, however, market's focus is firmly on Chinese property developer Evergrande's distressed financial situation and the possible spill-overs into the broader Chinese real estate sectors. Chinese markets are closed for a second consecutive day due to a national holiday, and the Hang Seng continued to be the absorb investors' concerns on the matter, although only trading 0.5% lower this morning. While an S&P report clearly indicated that Evergrande is likely to default without state support, a positive piece of news came from Hong Kong's largest real estate developer Sun Hung Kai, which denied speculation that Beijing is pressuring HK developers. Western equity futures are mixed this morning, with European stock indices set to open flat while the US ones are trading in the green (Dow and S&P500 +0.5%).

We could be looking at some tentative sigs of stabilisation in market sentiment today after yesterday's big slump in equities, but with Chinese markets re-opening tomorrow, it seems too early to expect calmer waters just yet.

In FX, the sharp drop in equities has not translated into USD strength across the board yesterday and this might be due to some investors possibly expecting that the Fed will refrain from sending any hawkish signal given the current turmoil in the stock market. Accordingly, any fresh hits to sentiment may be channelled mostly through JPY and CHF defensive trades rather than through the dollar.

This more optimistic market sentiment is seeing the highest-beta currencies rebound this morning, and in particular NOK and CAD. The latter appears to have been only marginally touched by the outcome of Canada's federal election, which showed PM Justin Trudeau's Liberals securing exactly the same amount of seats – 157, not enough for a majority government – as at the 2019 election. With Canadian politics back to a not-so-stable status-quo after the vote, we think it may still take some time for any political risk premium embedded in CAD to be trimmed, as investors weigh Trudeau's spectrum of possibilities (in short, either defaulting to a case-by-case support or seeking a coalition deal).

EUR: Benefitting from low-yielding status

The intensifying central bank activity this week means that the focus should mostly be on EUR crosses as other European currencies may see idiosyncratic drivers while the eurozone's calendar looks quite dull before Thursday's PMIs. Incidentally, remarks by some ECB speakers have followed the recent cautiously optimistic stance heard around Frankfurt, and ultimately had no impact on the euro. We do not expect anything different should vice-President Luis de Guindos deliver some policy-related comments this morning.

EUR/USD should remain solely remain driven by the dollar and global sentiment dynamics. For now, the EUR's low-yielding status appeared to keep the common currency relatively protected from swings in sentiment, especially when compared to the higher-beta GBP. EUR/GBP is surely an interesting pair to keep an eye on, as more risk-off waves could prompt a break above 0.8600 this week.

SEK: Let down by lack of hawkish signals by the Riksbank

As discussed here, markets are likely expecting some hawkish tilt at today's Riksbank meeting after the strong August CPI numbers. We think the statement could include some reference to the reduction of bond holdings in 2023, but we doubt any detailed plan will be provided in that sense. Ultimately, markets will mostly watch the rate and inflation projections to look for hints of a more hawkish tone, and we suspect they may end up disappointed.

The rise in inflation was not matched by any increase in the Prospera inflation expectations, and we think the Riksbank may want to see some evidence that price growth is persistent before turning less dovish. While there is a risk we could see a rate hike being pencilled in the 2024 projections, we are inclined to think the rate path will not be touched at all, and inflation forecasts beyond the short-term should not be materially upgraded.

All in all, we expect a negative impact on SEK today as hawkish expectations are not met, and EUR/SEK may rise back above the 10.2000 level.

HUF: NBH has good cause to hike

The NBH meets today to set interest rates. The vast majority of those surveyed by Bloomberg expect the 1.50% base rate to be hiked, but estimates of the hike look evenly split between 15 and 30bp. ING's Peter Virovacz looks for a 25bp hike and further indication that the base rate be hiked towards 2.50% by year-end – a move yet to be fully priced in by money markets.

EUR/HUF has seen a volatile ride over recent weeks - occasionally pressing the lows at 347/348, but also rallying on: i) HUF implied yields briefly turning negtaive, ii) over-heating fears as the government plans to issue debt and potentially spend a lot by year-end and iii) most recently the shift in global risk sentiment.

Assuming the NBH does deliver a hawkish 25bp hike today, we think the EUR/HUF rally can be contained. Indeed, the market may start to look at HUF through the prism of loose fiscal and tight monetary policy and as long as NBH delivers the tight monetary policy part, EUR/HUF should trade back below 350 again when global risk sentiment settles.

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