

FX Daily: Bond rally provides temporary reprieve to FX markets

Monday's recovery in US bond markets after the US ten-year Treasury yield hit 5.00% has seen the dollar correct lower. Technically, it looks like this correction could extend, with the most likely channel weaker US equity markets and a repricing at the short-end of the US curve. Look out for PMIs around the world today and possibly a large rate cut in Hungary



Higher US Treasury yields have been a dominant force driving the dollar higher over recent months, bolstered by strong macro data and the Fed's higher-for-longer narrative

📌 USD: How far will the dollar correction run?

Anyone returning to work today after a long weekend might ask what on earth happened in the US bond market yesterday. Having traded to 5.02% in early Europe, the ten-year Treasury yield dropped to the 4.83/84% area through the session. There was no US data nor Federal Reserve speaker to justify this. Instead, it seems a tweet by Bill Ackman, the CEO of Pershing Square Capital Management, was enough to help turn the ten-year from the big psychological 5.00% area. To be fair, Ackman had a great call earlier this year when he targeted 30-year US yields above 5.00%. His rationale for closing his short bond position was that there was too much risk in the world and that the US economy was weaker than it appeared.

Higher US Treasury yields have been a dominant force driving the dollar higher over recent months, especially when the moves have been driven by strong US macro data justifying the Fed keeping rates higher for longer. However, unless we start to see some sharply weaker US data coming through, it is hard to see the long end coming a lot lower. Indeed, the fiscal risk premium looks likely to stay in Treasuries as the market awaits the announcement of the US quarterly refunding on 1 November.

Perhaps where there is a little more direct risk is in US equity markets. The S&P 500 had a weak close despite lower bond yields. Today sees many S&P 500 names release quarterly earnings, including two of the magnificent seven tech stocks, Alphabet and Microsoft. If this dollar correction is to extend, it may well be via a sharper correction in US equities triggering a re-pricing at the short-end of the US curve – the US two-year yield breaking back below 5.00%, for instance.

The US calendar today sees the S&P PMI releases. These have been a little weaker than their ISM equivalents, but numbers near 50 may not be market movers.

105.50/55 looks to be key short-term support for DXY, below which there is a risk of a sharp drop to 104.40.

Chris Turner

➔ EUR: Can the euro survive today's data?

Yesterday's dollar correction saw EUR/USD break through resistance at 1.0610/20, now support. This is the biggest correction we have had since the powerful bear trend started in July. An obvious target for this correction looks to be something like the 1.0765 area.

Whether we get to 1.0765 depends on US financial markets, [Thursday's European Central Bank \(ECB\) meeting](#) and today's eurozone data. Here, we see the October flash PMIs for Germany, France and the eurozone. These are all expected to signal ongoing stagnation or recession. At 10:00 am CET we will also receive the ECB's latest bank lending survey data for September. In August, bank lending [fell 0.4% month-on-month](#) and the data provided a bearish undercurrent for the euro.

On balance, we suspect this EUR/USD correction might last a few days and perhaps EUR/USD does not even get below 1.0650 now.

Chris Turner

➔ GBP: Focus on services PMI today

The UK data calendar today sees the delayed release of the September jobs data. These have not been a particularly big driver of financial markets, with the average earnings figures being more important. However, attention will be paid to the flash October PMI releases today, where any dip in the services index could help wipe out the final 10bp of tightening still priced into the Bank of England policy cycle.

We prefer EUR/GBP continuing to trade around the 0.8700 area, while a break above 1.2275 in GBP/USD warns there may be a corrective window to the 1.2450 area.

Chris Turner

📌 CEE: NBH starting second phase of cutting cycle

Today's agenda includes consumer confidence in the Czech Republic, labour market data in Poland and, most importantly, a meeting of the National Bank of Hungary (NBH). [We expect](#) the central bank to start the second phase of interest rate normalisation with a 50bp cut in the base rate. However, we see a risk that better conditions in recent weeks – lower inflation, a stronger HUF, and the prospect of a resolution to the dispute with the European Commission – increase the likelihood of a 75bp move as well. Surveys are mixed ranging from stability to a 100bp rate cut. However, the consensus is 50bp, as is our forecast, but 75bp is a close call here as well. Market pricing clearly favours a 75bp rate cut with a slight tilt towards a 100bp cut.

We believe today is not just about the specific move, but also the outlook for the rest of the year. The NBH's flexibility for its next steps has become a big topic and we expect the first step to be a guide for the rest of the year. In this case, the market is assuming more like 50bp steps later, in line with our expectations.

The FX market is one reason why we think NBH may decide in favour of a bigger rate cut today. EUR/HUF has hit its lowest levels since early September in recent days despite strong US dollar and geopolitical uncertainty, indicating market readiness for the start of the second round of the cutting cycle in our view. Therefore, we are rather positive on the HUF for today. In the event of a 50bp cut, the market has some room to correct short-term expectations towards smaller cuts further out, which would be positive for HUF. On the other hand, if NBH surprises with a 75bp rate cut, it should not have much negative impact on HUF given market expectations priced in here.

Elsewhere, the Hungarian minister for EU funds is also scheduled to speak today and could mention the status of negotiations with the European Commission regarding the release of EU funds after last week's meeting.

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