

FX Daily: Chasing the local stories

FX volatility remains near the lows as investors remain unconvinced that Jackson Hole will light a fire under markets. The gains earlier this week of riskier currencies against the dollar seem to be fizzling out, but there have been good local stories in Hungary and New Zealand. Expect a continued focus on local stories until a clearer \$ story emerges



➔ USD: Fiscal spending, Fed, and Delta

After a strong rally at the start of the week, the move in commodity currencies and EMFX against the dollar seems to be fizzling out. Perhaps that is not a surprise given Friday's event risk in the form of the Fed's Jackson Hole. It also should not be a surprise given the number of cross-currents at work at the moment. Should commodity currencies be rallying on news that the US House has made progress on passing a \$3.5trn social care law, which will also allow progress on the US\$550bn infrastructure package?

And how should we read the sharp rise in US case numbers as the Delta variant spreads? That could delay Fed tapering (good news for risk assets), but make a correction in US equities more likely as earnings expectations get revised lower (bad news). Suffice to say the dollar trend looks mixed at best. And there seem few inputs today - just July Durable Goods Orders - to alter the broad dollar environment.

Instead, expect more focus on local stories. Hungary's NBH yesterday **continued tightening** and started tapering. And it looks like the RBNZ wanted to put the record straight regarding events at last week's rate meeting. In an interview yesterday the deputy governor said the RBNZ would have hiked last week, but it would not have looked good raising rates on the day New Zealand went into national lockdown. The start of the RBNZ tightening cycle now looks fully priced for the October 6th meeting.

Other local stories to focus on will be whether the Bank of Korea is confident enough to start its own tightening cycle tomorrow - Rob Carnell, like 10 of the 19 economists surveyed - still thinks it is a little too early for the first tightening. And we will also see fresh inputs into the Latam tightening story today, where 2Q21 GDP is released in Mexico and August CPI in Brazil.

In all then it is a pretty mixed FX environment and low volatility suggests it is probably best to trade ranges. For DXY, that probably means a 92.80-93.20 range.

➔ EUR: When will German elections start to play a role?

This week's risk rally looks to be fading as we close in on the Jackson Hole event. Asian FX and equity gains have slowed a little, meaning that dollar selling pressure (as money is put back to work in EM) has faded. That means EUR/USD looks to be stalling near the 1.1750 area and we do not see a big catalyst for further gains. One wild card is the result of the upcoming German elections. With the SPD nudging ahead in the polls could we see expectations of looser fiscal policy drive European yields and the euro higher?

For today, the focus will be on the German August IFO. German manufacturers continue to struggle with supply chain challenges and the IFO expectations component is expected to correct to 100 from 101.2. Any larger than expected drop here could marginally weigh on EUR/USD, though 1.1700 support should hold in quiet markets. Also, look out for a speech from ECB VP Guindos at 1030CET. This may be one of the last chances for the ECB to shape market expectations ahead of the Sep 9th rate meeting.

EUR/HUF is opening up offered again after yesterday's NBH hike. The scale of the tightening cycle has not altered, but by tapering its bond-buying scheme one could argue that the NBH is increasingly confident of delivering its cycle. The clearer move seems to come on the asset swap side, where government cash bonds are cheapening versus HUF swap rates. This trend may well continue.

➔ GBP: Nothing to see here

GBP remains very much range-bound, with few immediate drivers seen on the horizon. GBP may take some lessons from Hungary, however. Recently there has been a debate as to whether the start of BoE tapering could see the terminal rate in the tightening cycle priced lower and be bearish for a currency. Hungary's test case suggests the FX market rewards a taper with a stronger currency.

EUR/GBP and Cable remain well entrenched in recent ranges.

⬆️ MXN: GDP and infra-structure to keep MXN supported

With a neutral risk environment and range trading favoured we do think the MXN is trading on the

weak side of recent ranges and that USD/MXN could make a return to sub 20.00 levels into next week.

Yes, MXN is a high beta currency and will get hit if Jackson Hole triggers a disorderly sell-off in US Treasuries, but it should be one of the preferred currencies if risk assets can survive the weekend. Progress on the US infrastructure bill will be welcome, as will a potential turnaround in the commodity complex over the last few days (USD/CAD seemed to have a capitulation rally last Friday). One to watch.

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