FX Daily: China adds to the reflationary mix

Chinese policymakers have delivered on yesterday's speculation with a set of monetary loosening measures. Along with the Fed's larger rate cut, this can add to reflationary sentiment, lift equities and support the pro-cyclical currencies. This is mildly negative for the dollar. Elsewhere, look out for a 25bp rate cut in Hungary today

The People's Bank of China in Beijing

USD: Reflationary policies are a mild dollar negative

The top news this European morning is a package of monetary easing measures delivered by Chinese authorities overnight. Our Chief Economist for Greater China, Lynn Song, details the measures in this article. It is tempting to describe these measures as a monetary 'bazooka', but as Lynn highlights there is much work to be done to get Chinese demand back on its feet. However, these measures have delivered decent 3-4% gains in local equity markets and a similar jump in iron ore, seen as a key benchmark for the Chinese property sector. Whilst in theory monetary easing should be negative for a currency, USD/CNH has in fact broken down to a new low. We suspect this reflects both Chinese exporters belatedly hedging dollar receivables, but also a re-rating of the China investment thesis and investors being forced to pare back underweight positions in China.

What does this all mean for the dollar? Chinese measures add to the reflationary sentiment we were discussing in yesterday's FX Daily. This environment is characterised by steeper yield curves, higher equities and as we pointed out yesterday normally sees the benchmark reflationary FX pair, EUR/AUD, come lower. Indeed, EUR/AUD has dropped 1.3% over the last 24 hours. For the dollar itself, a reflationary environment is mildly negative as investors rotate into more pro-cyclical and EM currencies. However, in today's environment, investors need to be very selective as to which currencies they choose to hold against the dollar. For example, European FX looks very mixed at the moment and the euro will be struggling with fiscal consolidation over coming years – and potentially sending it on a collision course with the US over trade policy given Europe's export growth model.

For today the only US data of note is September Conference Board consumer confidence. With equities doing well, this is expected to tick a little higher and keep the soft landing in play. Given more manufacturing malaise expected out of Germany today and the euro's large weight in the DXY, this probably means DXY continues to trade in a tight 100.50-101.00 range. However, if a recovery in Chinese domestic demand is the flavour of the day, expect currencies like the South African rand, the Brazilian real and the Australian dollar to do well.

Chris Turner

EUR: Bracing for some more soft data

After another drop in the eurozone manufacturing PMI yesterday and the composite index dropping into contractionary territory, investors will be bracing for a soft German Ifo number today. Indeed, yesterday's swathe of PMI data took its toll on the rates markets (two-year EUR swap rates off 7bp) and the euro. Were it not for the global inflationary environment EUR/USD would look more vulnerable under 1.1100. For the time being, however, we slightly favour this 1.1100-1.1150 range to hold, with the best news for EUR/USD potentially coming with US price data on Friday.

As above, we continue to see the possibility of EUR/AUD trading lower and expect that the trend could extend to 1.60. Helping the move is the consistently hawkish Reserve Bank of Australia. The RBA remains definitely on inflation-watch and looks unlikely to cut rates this year.

Chris Turner

GBP: Sterling soars

Sterling continues to perform well. The majority of yesterday's drop in EUR/GBP was down to the miserable eurozone PMI data for September. In addition, the market is looking at some headlines coming out of the Labour Party conference in Liverpool. The focus here has been comments from Chancellor Rachel Reeves hinting at a loosening of fiscal rules which will allow for greater investment. Speculation is growing that there could be a change in the accounting treatment for some of Labour's new institutions – such as the National Wealth and GB Energy – which could potentially unlock an extra £15bn of borrowing. So far the UK sovereign CDS has not widened on this and the concept of these plans seems credible so far.

But sterling has enough support at the moment without these potential investment plans. We do not see GBP/USD positioning as particularly stretched and given perhaps a softer dollar environment, the direction of travel continues to be towards 1.35. EUR/GBP has impressed by taking out support at 0.8340/45. Next stop, 0.8300.

Chris Turner

HUF: NBH continues in cutting cycle

The National Bank of Hungary is scheduled to meet today and we expect a 25bp rate cut to 6.50% in line with market expectations. Even before the Fed's latest decision, we were leaning towards a 25bp cut at the September NBH meeting. Post-Fed, we see a non-negligible chance of a slight dovish shift in forward guidance, with the 6.00-6.25% range cited as a realistic target for the 2024 terminal rate.

The NBH will publish its latest set of macroeconomic projections for the main measures (GDP and inflation) alongside the interest rate decision, while the detailed September Inflation Report is due on 26 September. Given the downside surprise in second quarter GDP growth and the weaker-than-expected start to the third quarter, we expect a significant downward revision to the GDP forecast. After a 1.0ppt cut, we see the central bank's forecast range for economic activity this year at 1.0-2.0%. The lack of domestic demand is worrying enough to prompt a 0.5ppt downgrade in 2025 GDP growth to a range of 3.0-4.0%.

On the inflation front, actual headline data since the June forecast release has been more or less in line with the projected path. However, as we approach the end of the year, we expect the NBH to narrow its forecast range from 3.0-4.5% to 3.5-4.5%, as the lower end of the previous forecast has become statistically unlikely to be reached. While we see average inflation next year above but close to 4%, we don't think the central bank is ready to pull the trigger on a forecast change just yet. In turn, the NBH's inflation forecast for 2025-2026 will remain at 2.5-3.5%, in our view.

We expected to go into the meeting with a range of 392-393 EUR/HUF. While the rate differential still points to these levels, weaker German numbers and a weaker EUR seemed to pull down most CEE currencies yesterday. As we pointed out earlier, the risk is a dovish move in NBH communication, and market pricing seems rather neutral to us given the macro numbers in recent weeks. The indication of more rate cuts in our view would translate into further rate receiving in the HUF market, and so we could see a continuation of the reversal in EUR/HUF that may have already started yesterday.

Almost since the beginning of this year we have been using the 390-400 trading range framework for EUR/HUF, which has worked very well. In recent months the space has probably narrowed to 392-400. While we see a move to the upper bound of the range, we think it is too early to go above 400. One of the reasons is a higher EUR/USD. which will dampen the pressure on HUF, but also a potentially hawkish NBH reversal if HUF comes under pressure.

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