

## FX Daily: Dollar bears being asked for patience

Quiet summer markets are seeing dollar pairs consolidate in new, slightly lower ranges. It will be another quiet session today ahead of a big week for G3 central bank meetings. Dollar bears may find some reassurance from emerging markets, where the PBoC is trying to limit USD/CNY gains and the South African rand is holding up despite the lack of a rate hike



### ➔ USD: Dollar reconnects with short-term rate differentials

As my colleague Francesco Pesole has been [writing this week](#), the dollar has made a modest comeback as both US yields adjust higher and short-term rate spreads stay in the dollar's favour. In fact, one could argue that the dollar should even be a little higher given that two-year US yields have retraced about 50% of their drop in the first half of July and the DXY has only retraced one-third of its losses. Price action over the past week probably shows that a switch to the disinflation trade will not be easy and will require a constant drip feed of supporting evidence – be it softer price or weaker activity data. Yesterday's drop in US initial claims clearly did not help here.

Casting around the world in quiet FX markets we see the People's Bank of China (PBoC) continuing

to fight a weaker renminbi by printing lower USD/CNY fixings than model-based estimates suggest. Despite credible calls for a lower renminbi to support growth and battle deflation, it seems Chinese policymakers prefer to keep renminbi losses contained and prevent a 'sell China' mentality building. The PBoC's battle against a stronger USD/CNY is a slight dollar negative in quiet summer markets – especially should it extend to outright dollar sales.

Today's session should be a quiet one as the market prepares for US Federal Reserve, European Central Bank and Bank of Japan (BoJ) meetings next week. Regarding the BoJ, expectations of any Yield Curve Control policy tweak seem very low (perhaps too low) given that the 30-year Japanese government bond (JGB) yield is drifting lower and the forward market prices 10-year JGB yields at 50bp in three months and at only 55bp in six months. These 10-year yields should be priced a lot higher were the market expecting a policy change. USD/JPY may well drift to the 141.15/142.00 area before next Friday's BoJ meeting.

DXY can probably trade a 100.50-101.00 range today.

*Chris Turner*

## ➔ EUR: Reconnecting

Yesterday's drop in EUR/USD looked to be a function of the sharp drop in US initial jobless claims – pointing to a firm jobs market – but perhaps also some FX options-related flows given a lot of the move came after the 16CET FX option expires. The EUR/USD drop did, however, see EUR/USD reconnect both with short-term rate differentials (still wide at nearly 130bp in the dollar's favour) and also the still steeply inverted US yield curve. Both of these variables have to change if the EUR/USD is to embark on a big cyclical rally.

On the subject of the FX options markets, it seems investors have yet to cross the bullish Rubicon for the EUR/USD. Looking at the risk reversal – or the price for a 25 delta EUR call option over an equivalent EUR put option – the risk reversal continues to favour EUR puts. The one-month risk reversal has not favoured EUR calls since early 2022 and a switch by investors back to favouring EUR calls would represent an important sentiment shift.

Back to today, EUR/USD could drift down to support at 1.1100/1115 but that may well be the lower end of the range heading into next week's central bank meetings.

*Chris Turner*

## ➔ GBP: Strong June retail sales provide a brief lift

Sterling is rallying this morning on the back of strong UK retail sales data for June. Unseasonably warm weather for the UK last month was seen to be behind the bounce. The data will also feed into the Bank of England's narrative that the consumer can handle higher interest rates. The release has triggered a 20 pip drop in EUR/GBP. However, we think EUR/GBP probably put in an important low near 0.8500 earlier this month and that corporates will now use any EUR/GBP dip below 0.8600 to increase hedges on sterling receivables.

As an aside, reports are suggesting that Prime Minister Rishi Sunak will be opting for a UK general election in November 2024, i.e. as late as possible to allow more chance for the UK economy to recover.

Chris Turner

## ➔ ZAR: Rand withstands the SARB skipping a rate hike

In a mark of how far the mood in the FX market has changed, the South African rand only dropped around 0.5% on yesterday's decision from the South African Reserve Bank (SARB) to keep the policy rate unchanged at 8.25%. The market had widely expected a 25bp rate hike. Barely a few months ago a decision like this would have caused heavier losses for one of the most volatile emerging market FX pairs in USD/ZAR. The vote was close – three to two in favour of unchanged rates – but now the market thinks that the SARB has concluded its tightening cycle and will be easing policy in the first half of next year.

The fact that the rand did not sell off more shows that investors feel calmer about inflation prospects and increasingly like high-yield EMFX ahead of a possible cyclical dollar decline later this year. The rand of course has its challenges such as weak growth, a widening current account deficit, and the geopolitical headwinds of its relationship with Russia. However, if we are right that portfolio flows to EM rebound later this year, the rand should do well given South Africa's large weighting in EM bond and equity benchmarks.

As for most other high-yield EM currencies, we think the rand can outperform the steep USD/ZAR FX forwards curve.

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