FX Daily: Dollar momentum continues to build

Above-consensus US retail sales and a dovish cut by the ECB are adding fuel to the dollar rally. USD/JPY above 150 will retest Japanese officials' patience, while cable's relative resilience may not last long. EUR/USD downside risks extend to 1.07 in the near term when adding potential defensive positioning ahead of the US election

USD: Dollar rally has more to go

US retail sales came in strong yesterday, and the timing of their release (15 minutes after the European Central Bank cut) worked perfectly to favour another leg higher in the dollar. USD/JPY finally made the seemingly inevitable break above 150.0, but we would not be expecting a straight-lined appreciation in the pair from here as Japanese authorities may step up verbal intervention. Markets should be more attentive to currency comments than in previous JPY selloffs given the success of the latest round of Bank of Japan FX intervention.

That said, unless markets regain some confidence in Fed cuts, the dollar will hardly face downward corrections in the near term. The risk now is that markets might actually price out one cut in either November or December (currently 42bp priced in total) should core PCE and above all October jobs figures come in a bit hotter.

Still, that is not as big an upside risk for USD as the US election. We still think some de-risking into 5 November can lead to some defensive flows into the dollar, and that the likes of the Australian and New Zealand dollars are due another leg lower into the election. The antipodeans are highly exposed to tariffs on China, which may well overshadow any benefit from Beijing's stimulus measure. Overnight we saw China's 3Q growth numbers at 4.6% year-on-year vs the 4.5% expected. In the commodity FX space, we continue to expect outperformance by the Canadian dollar, also since we narrowly favour an out-of-consensus 25bp cut by the Bank of Canada next week.

Back to the US, the calendar is quite light today and only includes some housing data for September. We'll be monitoring whether any of today's Fed speakers (Raphael Bostic, Neel Kashkari and Christopher Waller) take an extra step to the hawkish side on the back of yesterday's retail sales numbers. DXY might be due some small and short-lived corrections, but we can easily see it climb above 104.0-104.5 in the next couple of weeks.

Francesco Pesole

EUR: Lagarde puts a cap on the euro

ECB President Christine Lagarde sounded a bit more dovish than usual at yesterday's post-meeting press conference. She emphasised the ECB's greater confidence in the disinflation path, and while she said the activity picture only influences policy decisions insofar as it affects inflation, the general perception is that the focus has started to shift from inflation to growth. As our ECB watcher, Carsten Brzeski, points out here the drop in September's headline inflation was in line with the ECB's own projections, so it must have been the grim PMIs that tilted the balance to the dovish side yesterday. Lagarde repeated at least twice that the ECB is data-dependent and not data-point dependent, but a dovish reaction to an activity survey would instead point to the latter.

If indeed the focus is now more on growth, we can probably conclude that the ECB will keep cutting, as the activity outlook will hardly improve much in the near term. Markets agree and are pricing in 100bp of easing in the next four meetings (December, January, March, April). That is probably the maximum the ECB can deliver, and there are risks of some hawkish repricing helping front-end euro rates around the turn of the year.

But with regards to the near-term picture, the euro is left weaker, with more limited room for a rebound as the two-year swap rate gap with the dollar is now at -140bp, the widest since May. This is consistent with EUR/USD trading below 1.080, and given the risks are skewed to a firmer USD into a closely contested US election, 1.070 is well within reach before month-end.

Francesco Pesole

GBP: Cable can slip to 1.28

September's better-than-expected UK retail sales data, which comes on the heels of decent August growth, is another sign that the economy is still performing relatively solidly. The consumer is benefiting from strong real wage growth, though we don't expect the growth rates we saw in the first half of the year to be repeated in the second. Still, growth data is of secondary interest for the BoE right now. This week's surprise dip in services inflation is more important, suggesting back-to-back rate cuts are becoming more likely.

Sterling has proven to be a bit more resilient than we had thought after that sharp downward surprise in services inflation on Wednesday. Cable has hovered around the 1.30 mark, and so far failed to make another decisive move lower. Still, we think the balance of risks remains skewed to the downside.

Even with less than two Bank of England cuts priced in by year-end, the two-year swap rate gap between sterling and the dollar has now tightened to 19bp from 55bp at the start of October. The last time we saw that spread around these levels (early August) GBP/USD was trading at 1.28, and barring major US data downside surprises, we see no strong argument against a move to that level.

Francesco Pesole

CEE: FX welcomes central bankers' hawkishness but rates remain under pressure

As expected, the Central Bank of Turkey (CBT) left rates unchanged at 50% and added a bit to its hawkish communication. The statement turned cautious as a result of increasing uncertainty surrounding the pace of inflation improvements. The CBT reiterated that its tight monetary stance would lead to a) a decline in the underlying trend of monthly inflation by moderating domestic demand, b) real appreciation in the Turkish lira, and c) an improvement in inflation expectations. We believe there could be room for a first rate cut in December, but it will, of course, depend on the October and November inflation numbers. On the positive side, the CBT seems to be aware of the situation and the risk of a mistake is diminishing, which should confirm the bulls in the TRY market.

In Hungary, the National Bank of Hungary's deputy governor reiterated that the pause in the rate-cutting cycle may be longer given the headwinds in the EM space. Although the market is pricing in a first rate cut only in January and around 50% for December, the headlines supported the currency and for a while, we got below 400 EUR/HUF. However, yesterday rates and bonds across the region came under pressure again due to higher core rates in the US, which later reduced some gains in FX as well. We'll hear more next week when the NBH is scheduled to meet. It's already almost certain that a rate cut is not on the table, but we could hear more details on how long the pause in the cutting cycle may be.

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