

## FX Daily: Dollar soft momentum unlikely to last

Except for the yen, all G10 currencies strengthened against the dollar this week. However, we think this is mostly due to some USD profit taking, and we expect the greenback to re-join its upward trend soon. Elsewhere, it appears that hawkish ECB remarks and dovish BoE remarks failed to materially impact the market's rate expectations.



### ➔ USD: Profit taking likely behind USD soft momentum

The dollar has given up some of its recent gains this week, but we are reluctant to see this as a signal that the bullish sentiment on the greenback is abating. It appears more likely that the modest correction was triggered by some profit-taking on long dollar positions as markets now fully price in the start of Fed tapering by year-end and the first hike in September/November 2022. After all, [latest CFTC positioning data](#) showed that the aggregate dollar positioning vs G10 currencies had risen to 13.9% of open interest in the week ending 5 October (the highest since November 2019), so some long-squeezing in the dollar seems quite plausible.

It's been a very good week for the AUD and NZD, rallying on the back of a general rebound in risk sentiment while also benefitting from China's real estate market turmoil losing some centrality. The yen, instead, remains heavily pressured, as the rebound in equities fuelled by strong US bank

earnings likely offset any potential help coming from the decline in US 10-year yields this week.

Today, the US calendar includes September retail sales as well as the Empire manufacturing index and the University of Michigan survey for October, but we expect the releases to have a contained FX impact. We'll also hear comments from one of the most hawkish FOMC members, James Bullard, and from the generally more dovish John Williams. Bullard already spoke yesterday, and claimed he sees 50% probability of inflation proving persistent, so it's likely markets will focus more on any policy comment by Williams.

While we don't think the dollar downward correction has legs, we may have to wait for the next week to see the greenback re-join its upward trend, and DXY could close the week around the 94.00 level.

## ➔ EUR: EUR/USD rally should lose steam soon

Following a clear dominance of dovish comments by ECB policymakers, it was the turn of Klaas Knot – the Dutch Governor – to live up to his reputation as a hawk and ring the bell against an overly relaxed stance towards inflation, which may prove more persistent than expected in his view. However, markets remain highly reluctant to take the view that the more robust dovish front within the Governing Council will budge anytime soon. Accordingly, EUR/USD remains almost solely driven by dollar dynamics and the lack of any clear idiosyncratic upside catalyst for the euro is likely limiting the pair's upside.

As discussed above, we do not expect the dollar's soft momentum to last. In EUR/USD, we think the rebound could follow a similar path to that seen in the first days of October, therefore stalling around the 1.1640 level.

## ➔ GBP: Looking a bit complacent on Brexit noise

If yesterday was the turn of an ECB hawk to make policy remarks, quite the opposite happened in the UK, where two generally dovish BoE members (Catherine Mann and Silvana Tenreyro) pushed back against the risk of persistently higher inflation and the need to tighten policy earlier than previously signalled. The markets likely contributed to the market moderately scaling back tightening expectations in the UK this week, although the OIS curve continues to fully price in 15bp of tightening by the December 2021 meeting, and 75bp within the next year.

Aggressive rate hike expectations continue to offer some underlying support to sterling, and EUR/GBP may stay broadly offered and touch new one-year lows today. Looking beyond today's price action, we still think sterling may have to give up some of its recent gains as our economist expects the BoE to underdeliver on monetary tightening. We also note that sterling appears somewhat complacent to the new frictions between the EU and the UK and the quite material risk of the bloc imposing retaliatory trade measures should the UK unilaterally suspend parts of the Northern Ireland protocol. We should hear more on this topic today.

## ⬆️ Egyptian Pound: JPM bond index conclusion to help?

Earlier this week JP Morgan confirmed that the local currency bonds of both Egypt and Ukraine would be included in its widely followed GBI-EM government bond index next year. Egypt would be joining at the end of January 2022 with a 1.85% weighting – equating to \$24bn in notional bonds. Ukraine would join at the end of March 2022 with a 0.12% weight (a single bond is being included)

– equating to \$1.5bn in a notional bond.

We mention this because Israel's inclusion into FTSE Russell's WGBI in early 2020 helped cement the positive trend for the ILS in late 2019 – although the notional figure of ILS bonds joining was larger at \$70bn. The argument behind the currency rally here is that passive index trackers who don't own EGP or UAH local currency bonds already, have to buy them.

The Egyptian Pound (EGP) is a heavily managed currency and occasionally sees carry trade flows on the back of its high yields – 7%+. The bond inclusion story could also help here. Although Egypt's high yields are not as exceptional as they once were. And 7% yields are now matched, amongst others, by Russia. Giving the Rouble the advantage over the EGP is also a current account surplus of 7-8% of GDP and a 5 year sovereign CDS trading at 85bp – compared to a 4% current account deficit for Egypt and a CDS trading at 458bp. Pound for pound, we prefer the Rouble.

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