

FX Daily: Don't get too excited with the bond rally

US yields continued to correct lower on expectations the Fed will let markets do the tightening and refrain from hiking again. We suspect, however, that further bond rallies might put a hike back on the table, and limit USD losses. We'll watch US PPI figures and the Fed minutes today. We have published estimates for the Riksbank's hedging data out on Friday



USD: The risks of excessive correction in yields

The bond market has continued to recover on the back of expectations that the Federal Reserve may let higher rates do the tightening and refrain from delivering other rate hikes. The Fed Funds future curve currently prices in only a 30% implied probability of another hike by December, down from 50% a week ago and after strong jobs figures on Friday.

The correction in 10-year yields is spilling into the FX market via a modestly weaker dollar. We have some doubts this is a dynamic that can continue to apply pressure on the greenback though. To use FOMC member Neel Kashkari's words, "if those higher long-term yields are higher because their expectations about what we're going to do has changed, then we might actually need to follow through on their expectations in order to maintain those yields". In other words, should market rates decline much further, the chances of another rate hike by the Fed may well rise at the same time, limiting the dollar's losses.

US inflation figures could throw cold water on the bond relief rally this week. September's PPI figures are out today, and the consensus is expecting another 0.2% month-on-month core reading, while the headline rate should slow down from August's 0.7% (expected 0.3%). We see upside risks to the consensus reading, and have a bullish bias for the dollar today. The CPI numbers will be released tomorrow.

We'll also take a look at the minutes from the September FOMC meeting. One first point of focus for markets will be the economic assessment. It seems likely that the consensus message will be no recession and a soft landing. The balance between a dovish and hawkish surprise will probably be determined by how many ("many"/"most"/"several") participants saw rates at already restrictive levels. Markets have been reluctant to price in another rate hike and any reference to "several" members agreeing with this view would likely trigger a dovish reaction. The overall message should be tilted to the hawkish side anyway by a reiteration of the higher-for-longer narrative, backing the upward revision in the 2024 dot plot projections. Remarks by the Fed's Michelle Bowman, Christopher Waller, Raphael Bostic and Susan Collins will also be watched given the intensifying scrutiny on the higher market rates tightening debate.

The argument for a long-lasting dollar decline from these levels is not very compelling unless the drop in rates is endorsed by slower-than-expected inflation. We still think it will take a turn in the US data flow to drive the dollar substantially – and sustainably – lower.

Overseas, we are reading headlines of fiscal support likely to be deployed from Beijing. It would not be an automatic CNY-positive though, considering that this may require further currency-negative Required Reserve Rate cuts. There is probably better value in playing any tentative China optimism via proxy trades (e.g. Aussie dollar and New Zealand dollar against other pro-cyclicals).

Francesco Pesole

📌 EUR: Keeping an eye on inflation expectations

EUR/USD has stabilised at 1.0600, once again being driven entirely by the dollar correction and lacking any bullish push from the euro side. Today, we'll see the release of the European Central Bank's inflation expectations for August. The three-year-ahead gauge may have inched higher from 2.4% to 2.5%, this isn't a big change, but hardly a welcome development for policymakers, and might give some marginal support to the euro.

We'll also hear from three ECB speakers: Klaas Knot, Pablo Hernandez de Cos and Francois Villeroy. The latter vocally opposed raising reserve requirements in a speech yesterday.

Our short-term fair value model suggests that we could see the upward correction in EUR/USD extend to 1.0700, but we think that may be the top of the range unless US CPI surprises on the soft side. A return to 1.0500 appears more likely in the coming days, in our view.

Francesco Pesole

➡ SEK: Riksbank buying is keeping krona strong, for now

The Swedish krona has remained an outperformer in the G10 space, even though yesterday's GDP flash GDP figures for August disappointed (-0.2% vs 0.1% consensus). We still think the Riksbank's FX hedging operations are behind SEK's strength. We published [an article on this topic](#) ahead of Friday's release of the first set of data on FX reserves hedging by the Riksbank.

We estimate that equally-weighted daily purchase operations for five months (an average of the four-to-six month window set by the Riksbank) would amount to around USD\$100mln and EUR€26mln of daily sales, or a total of around USD\$490mln per week. That would equal only 0.16% of the EUR/SEK and USD/SEK combined turnover for the same period, and given the rather substantial impact of the FX operations so far, we cannot exclude that the Riksbank has purchased at a more aggressive pace in the first week.

After the figures are released on Friday, markets will be able to start assessing how much firepower the Riksbank has left to support SEK (even if this is not officially the goal of the hedging operations). The limitations to the size of the hedging programme mean, in our view, that it is unlikely to prompt a sustainable recovery in the krona by itself, and other drivers (mostly external) will remain the determining factors for EUR/SEK and USD/SEK.

Swedish CPI figures are out on Friday, and a slowdown in both headline and core inflation is expected. Markets are currently pricing in a 40% chance of another hike in November. EUR/SEK may hover around 11.50/11.60 into the release.

Francesco Pesole

📉 CEE: Lower inflation is bad news for FX

Today's calendar in the region is basically empty. Thus, markets should continue to absorb yesterday's inflation numbers in [Hungary](#) and the [Czech Republic](#). In both cases, it was a downside surprise that gave the markets renewed momentum to bet on both central banks' rate cuts, which of course was reflected in the FX market.

In Hungary, basically the entire FRA and IRS curve shifted down by around 25-30bp, almost returning to the levels before the last National Bank of Hungary meeting in September, pricing in more of a rate cut in the 75-100bp range at subsequent meetings. However, we continue to expect a 25bp cut in the base rate at the October meeting, with the possibility of a 50bp cut if global conditions calm down by then. However, for now, the forint has again lost the support of higher rates in the market and the potential we mentioned yesterday is gone. Yesterday's drop in rates is in line with current levels in our view, but we can expect the market to move rates a bit lower today again, which would lead to a higher EUR/HUF. Thus, we could see EUR/HUF closer to 390 today.

In the Czech Republic, we see a similar picture. After surprisingly low inflation, the market has fully returned to the game of cutting rates at the next meeting in November, possibly by more than 25bp. We expect 25bp in November, however, until then we will still see crucial data from the labour market and of course, the central bank will be watching EUR/CZK. Based on the comments by the Czech National Bank deputy governor yesterday, it seems that touching 24.60 yesterday was not a problem for the central bank. We see the 25.0 level as a pain threshold, which is not within reach for now in our view. But as in Hungary, we can assume that the market may still move rates lower, which could push EUR/CZK above 24.60.

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