FX Daily: Fed feeds the risk rally

Risk assets continue to perform quite well despite what seasonal trends might suggest. The dynamic here seems to be that second wave challenges in the US will keep Fed policy looser for longer, thereby keeping pressure on the dollar

Source: iStock

USD: Lower for longer US rates feeds the risk rally

Risk assets continue to perform quite well despite what seasonal trends might suggest.

The dynamic here seems to be that second wave challenges in the US will keep Fed policy looser for longer, thereby keeping pressure on the dollar. Overnight, San Francisco Fed President, Mary Daly, said that the US economy will need longer support. That has seen Fed funds futures contracts nudge up and progressively price a negative Fed funds rate from summer 2021 through summer 2022. Speculation is also building about what further support the Fed can offer at its 16 September meeting, including yield curve control.

Congressional wrangling over how to structure the next stimulus package is adding to this narrative, as will today's ADP figures, should they disappoint the +1.2m consensus figure. Also helping the slightly pro-risk mood is: (a) a big draw-down in API crude oil inventories to support crude prices, and (b) USD/CNY breaking to a new low. Here US-Chinese officials meet on 15 August to review the phase-one trade deal and a modicum of Renminbi strength may soften discussions.

DXY may well be entering a 92.50-94.00 trading range but expect participants to maintain a sell dollar rally mind-set.

EUR: The dollar alternative

With the largest weighting in the dollar's trade-weighted index (17% in BIS measures) any trend towards a weaker dollar will lift the EUR.

1.1700 looks like it was the corrective low this week in EUR/USD and we would favour a little more consolidation here, before an assault on 1.20.

Yesterday we published an article on a factor that could generate a 1.25 scenario. The buy-side is tempted to rotate into European equities but has yet to do so.

Let's monitor this story.

GBP: Car registrations rebound in July

Early data today sees UK new car registrations rebound 11% YoY in July. That is to be expected given the declines seen from March to June. We continue to see any move in EUR/GBP under 0.90 as short-lived and await tomorrow's Bank of England meeting.

SEK: Will GDP data be better than the rest?

0930 CET sees Sweden release GDP data. Given Sweden's less repressive lockdown regime, expectations (including at the Riksbank) are that Sweden has not been hit as badly as the rest of Western Europe (Eurozone GDP -12% QoQ in 2Q20).

The consensus is for an 8% QoQ decline in Sweden. A number like that or better could send EUR/SEK back to 10.22 given a positive external environment.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com