

FX Daily: Fresh US-China tensions could trigger USD rebound

Nancy Pelosi's planned visit to Taiwan may renew US-China tensions, and in FX this could translate into a re-strengthening of the safe haven dollar and weakness in both CNY and China-sensitive currencies like AUD and NZD. AUD, in particular, is facing soft momentum as the RBA signalled inflation is near its peak. EUR/USD may retract to 1.0200



US House Speaker Nancy Pelosi is planning to visit Taiwan this week

USD: Time for a rebound?

The dollar's softish momentum extended into this week, as the narrative of a Fed pivot appears to be cementing among market participants, ultimately triggering another round of dollar long-squeeze. We still warn against the sustainability of such a dollar downtrend, as further scope for a dovish re-pricing by the Fed appears limited in our view and global economic/geopolitical uncertainty should still fuel some safe-haven bets on the dollar.

Yesterday's news that US House Speaker Nancy Pelosi is planning to visit Taiwan this week – she's reportedly due to land tonight – has prompted a reaction by Chinese authorities who threatened unspecified military action. Should this mark a material deterioration in US-China relationships, expect some shockwaves to be felt across the FX market. The dollar, the yen (which may break below 130.00 already today) and CHF should be the main beneficiaries, while CNY and China-

sensitive currencies (along with high-beta currencies in general) could come under pressure. Here, AUD and NZD appear mostly vulnerable in G10.

It is hard to predict how this new geopolitical thread will develop, and for now we simply highlight that this may be the trigger for an upside correction in the dollar today or in the coming days.

Back to the US, the first piece of labour data this week ahead of Friday's Nonfarm Payrolls will be today's JOLTS job openings for June, although the market impact should be contained. More focus should instead be on Fed speakers, as Charles Evans (dove), Loretta Mester (hawk) and James Bullard (arch-hawk) are all due to speak. The switch to a meeting-by-meeting approach by the FOMC should increase the relevance of policy comments by members, and given we'll hear from two hawks and one dove, the overall message today may support rate expectations and the dollar. Our base case for today is that DXY will be able to stage a rebound to the 105.50-106.00 area.

📌 EUR: Not many domestic drivers

The eurozone's calendar lacks any market-moving events today, and geopolitics (Taiwan/China and Ukraine/Russia) should be the main driver for EUR/USD. Generally, any unwelcome development in China-US relationships would put pressure on EUR/USD, both because the safe-haven demand for the dollar would rise, and because the eurozone's export machine is highly reliant on China's demand.

Even if this specific geopolitical risk related to Taiwan were to deflate, we still doubt that the EUR/USD rally will find much more steam from current levels, both because the room for further USD weakness appears to be shrinking and because EU-Russia relations and the region's economic outlook remain too uncertain to fuel a substantial return of bullish EUR bets. Incidentally, a further stabilisation in risk sentiment may encourage a search for carry, which could see the euro emerge even more as a preferred funding currency.

We suspect EUR/USD may fall short of breaking 1.0300 and looks more likely to re-converge to the 1.0200 gravity line in the coming days.

📌 AUD: RBA joins the Fed's data dependency

This morning, the Reserve Bank of Australia (RBA) hiked by 50bp as widely expected by the market, but the combination of a switch to a Fed-style fully data-dependent approach, and the view that inflation is expected to peak and moderate later this year, were read as dovish signals by markets. All this explains the Aussie dollar's negative reaction this morning, with the pair falling around 1.0% after the announcement.

We also suspect that the AUD drop was exacerbated by the risk of resurging Sino-American tensions. This should indeed be the major driver for AUD/USD for the coming days, and given that AUD and NZD are normally the most exposed G10 currencies to China-related sentiment, the downside risks are quite material. We could see AUD/USD test 0.6900 should tensions escalate.

Like in the US and the eurozone, expect RBA rate expectations and AUD to become significantly more sensitive to data releases from now on. Friday's Statement on monetary policy from the RBA may have some tangible market impact.

➔ CEE: Floating currencies close the gap

The Polish zloty and Hungarian forint reached our [yesterday targets](#) quickly and, in our view, closed the gap triggered by last week's FOMC meeting. Conditions remain supportive for the CEE region. EUR/USD is relatively far from retesting parity, global sentiment remains rather neutral or slightly positive and we see rising market rates in the case of the forint. Thus, we could see additional gains in the region in the coming days as well, but the further potential is limited. The zloty could touch 4.70 EUR/PLN and the forint 397 EUR/HUF.

However, for the current levels, we see more sensitivity against possible geopolitical shocks that lurk around every corner these days. Moreover, the forint will see a couple of key data releases this week, retail sales on Wednesday and industrial production on Friday, which could lead to a quick correction in case of a negative surprise. Compared to previous days, we are thus rather neutral on regional currencies.

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