

FX Daily: Gas-powered rallies for Norway and Russia

Away from the hot stories of which central banks are ready to normalise monetary policy, commodity markets continue to steal the show. This week it feels like surging natural gas prices in Europe are starting to make their mark in FX, with the currencies of big gas exporters Norway and Russia out-performing yesterday. Expect this trend to continue.



Source: Shutterstock

📉 USD: Weak August retail sales could weigh on the dollar today

A broad dollar trend has been conspicuous by its absence this week. Perhaps this should not be a surprise given conflicting themes around the world and also within the US as well. There is a creeping sense that with higher vaccination rates, Europe could be slightly more resilient than the US to fresh waves of the pandemic in the northern hemisphere this winter. Yet US growth is more proven and for financial markets, the Fed looks set to be well ahead of the ECB in normalising policy.

In the US today, the focus will be on August retail sales. ING's James Knightley is looking for a 1.5% MoM decline largely on the 11% volume dip in auto sales seen that month. This week the dollar has been edging lower on softer US data (e.g. Tuesday's lower than expected CPI print) though those intra-day losses have been quickly reversed. The same could be seen today - i.e. a 0.3-0.5% intra-day dip in the dollar on a soft retail sales release, but one that is quickly reversed. Indeed, it seems unlikely investors will want to build momentum behind any fresh trends in the dollar until the Sep 22nd FOMC event risk has passed.

Elsewhere, we are today focusing on surging natural gas prices in Europe. A European benchmark (TTF) now stands at EUR70/MWh, having started the year at EUR20/MWh. As [Warren Patterson explains](#) there are several factors driving the move, mostly supply-driven but also via the surge in carbon prices in EU ETS cap and trade system that has encouraged switching from coal to gas-powered energy. With gas inventory levels very low heading into the European winter, the risks to natural gas prices lie on the upside. This is a big deal for Europe, where gas comprises around 25% of energy consumption.

Where this connects with FX is through the terms of trade side. Norway and Russia are the big exporters of natural gas and yesterday saw their currencies out-perform. Both currencies are backed by hawkish central banks, though the CBR is towards the end of its tightening cycle, while Norway should start next week. We favour continued strength for both currencies.

There may also be focus on the other large natural gas exporter Qatar. Its 5 year sovereign CDS has been narrowing recently and investors may question whether 12m QAR forward points should not be trading closer to zero.

➔ EUR: ECB's Schnabel explains why bond yields are so low

The ECB's Isabel Schnabel delivered a magnificent speech to bond market participants yesterday on why sovereign bond yields are so low. The related [chart pack](#) was brilliant. Key take-aways for us were; a) dismissing the idea that low bond yields were driven by secular stagnation fears, since equity gains had largely been driven by higher earning expectations and b) the market waking up to the new reaction function of central banks, such that the policy trigger finger in response to higher inflation would be softer.

The implication for the EUR here, also referencing a chart that the risk distribution for 3m Euribor expectations was truncated from the top, suggests that it is going to take a lot for ECB policy to drive the EUR higher. We see EUR/USD in a 1.17-20 range until year-end and then heading lower through 2022 as Fed tapering turns into tightening.

For today, EUR/\$ could have another run at 1.1850 on soft retail sales, but end the day back at 1.1800.

Elsewhere in Europe, we see that the NBH has gained greater control of the HUF swaps markets, with 1m HUF implied yields now trading above 1% having been negative last week. This will allow investors to focus on what should be a 25bp hike from the NBH next week and send EUR/HUF towards our 1m target at 345.

⬆️ GBP: BoE expectations unhinged

GBP continues to hold its own and certainly the above consensus August CPI release made its

mark. ING's James Smith argues that the lifting of energy price caps in October could add 0.7% to headline CPI, potentially sending the October and November readings above 4% YoY.

Above consensus CPI has seen UK money markets react. Recently we had been highlighting that money markets had priced a firm pause in the BoE's policy rate at around 0.5% in 2023/24, when the BoE would start quantitative tightening. Yet money market rates have now pushed policy rate expectations up to the 0.60% area.

Should UK growth/inflation data come in on the strong side, the market's search for the BoE terminal rate could keep GBP supported. 1.3800-1.3900 should hold Cable near term.

CNH: Southbond bond connect to help CNH over CNY

The Renminbi continues to consolidate against the dollar, but stays very firm on a trade-weighted basis. We think this may suit the PBOC and Chinese policy makers who are still battling high commodity prices. In fact, it looks like China is just about to undertake a second round of sales of industrial metals from its strategic stockpiles.

At the same time the fate of the property developer, Evergrande, is very much in focus. A debt restructuring announcement is expected and presumably Chinese policy makers would want to limit the prospect of any contagion - which so far seems limited to Chinese real estate developers and the China HY debt market.

A very different, but long-running story is the opening up of China's capital account. A new chapter was announced yesterday with the launch of the southbound bond connect program, which allows mainland investors to invest in international debt markets. The scheme starts on Sep 24th with an initial allowance of CNY500bn. We wonder whether this will trigger new interest in the 'Dim-Sum' bond market, i.e. CNH denominated bonds issued in HK. We will therefore start to see whether the CNH-CNY basis widens in favour of the CNH. CNH 3m implied yields are also a very attractive 3.18% currently.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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