FX Daily: Hanging in there

Despite the ongoing China Evergrande saga plus views from many that equities are due a correction, risk sentiment remains surprisingly supported. Expect another quiet FX trading session before a busy week of central bank meetings.

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USD: Evergrande has yet to land the knock-out blow to risk sentiment

Despite fears that equity markets are due a correction around this time of year, none have so far been forthcoming. As ECB's Isabel Schabel pointed out earlier this week - for European equities anyway - gains have been driven by upward revisions in earnings expectations. While these upward revisions may be stalling in some sectors, there has yet to be a catalyst to trigger a sharp market correction.

One such potential catalyst is the stress in the Chinese real estate sector - primarily through Evergrande - though starting to creep through other real estate developers. It is hard to see any contagion beyond the affected shares and also the China high yield USD bond market. That said, the PBOC did add a lot of short-term liquidity overnight in the 7 and 14 day CNY repo markets, with a CNY90bn liquidity add versus CNY10bn of repo expiring. Quarter-end and a Chinese holiday are approaching, but still the size of the liquidity add surprised local money market traders and suggests the PBOC want to avoid any kind of stress in the system.

For today the US highlight will be the University of Michigan September survey - providing insights on consumer sentiment and inflation expectations. Sentiment had plunged in August, yet this dip did not seem to hit August retail sales. We think more interest today will be in the 5-10 year inflation expectations, which now stand at 2.9%. Any rise back to 3% or above could nudge US rates higher on the view that the Fed may not be as relaxed on inflation as they appear.

DXY to trade out a 92.50-93.00 range.

EUR: Hawks causing trouble?

Overnight we have seen the FT report an unpublished, internal study at the ECB suggesting that inflation could sustainably hit 2% by 2025, such that the ECB could start raising rates in 2023. The ECB has said the article is inaccurate. The move smacks of some of the ECB hawks trying to open up the debate on monetary normalization. The EUR has not reacted to the story, but the story does serve as a reminder that dissension could be growing and that over coming months Eurozone FX and rates markets could become more sensitive to any stronger growth or higher inflation data.

EUR/USD may trade a 1.1750-1.1800 range today. Elsewhere, it is interesting to see EUR/CHF move back above 1.09. One can perhaps argue that a higher EUR/CHF will be a key outcome of this dissent within the ECB. If there is any central bank that can out-dove the ECB, it is the SNB.

GBP: August retail sales disappoint

A poor UK August retail sales report may take some of the momentum out of the rise in UK money market rates and also GBP. Yet the BoE meets next Thursday and it seems unlikely that they, unlike the RBA earlier this week, would want to deliver a 'rate protest' against market pricing of the policy cycle.

Cable to continue to gravitate around 1.3800 and EUR/GBP remains supported near 0.8500.

CZK: More focus on 50bp hike Sep 30th

EUR/CZK dipped towards the lows of the year at 25.25 yesterday after a second CNB board member floated the idea of a 50bp hike at the Sep 30th rate meeting. Money market products (FRAs) suggest 35-37bp of tightening is priced for the Sep 30th meeting, suggesting that there could be room for some modest upside in rates and CZK if speculation builds that 50bp is possible after all.

EUR/CZK has been a very popular trade this year - both for direction and carry - and it looks like these trends will extend into the Sep 30th meeting.

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