FX Daily: Investors return to carry in quiet markets

FX volatility is edging lower, and in quiet markets investors seem to be parking their cash in currencies with higher yields. This serves as a reminder that within the G10 space, the dollar remains one of the highest-yielding currencies and that the weaker dollar story requires a drip-feed of bad news. Today, focus will be on the three-year Treasury auction

The dollar remains one of the highest-yielding currencies within the G10 space

USD: Focus on the $58bn 3-year auction

Examining FX performance from both a spot and total return perspective over the last month reveals a bloc of four currencies that stand out. These are the Norwegian krone, sterling and the Australian and New Zealand dollars. What does sterling have in common with these commodity currencies? High yields. Like the krone, sterling offers implied yields over 4% per annum. This is important because, by nature of the Fed's prolonged pause, the dollar also has yields at over 4% p.a. and taking a short position against the dollar will prove expensive unless investors get the timing right.

On that subject, Friday's US jobs data did not unleash another wave of pessimism on the US economy, and this week's US data calendar is light apart from tomorrow's release of May's CPI – which is expected at orderly/soft levels. Importantly, it doesn't seem that merely soft price data is enough to restart the Fed easing cycle. For instance, the Fed is probably looking at a 5-year, 5-

year USD inflation swap and noting it at a very comfortable 2.5% – portraying no signs of recessionary/deflationary fears.

Today should be another relatively quiet session, which can see volatility contained and investors leaving their funds in the higher yielders. On the radar, however, is tonight's $58bn 3-year Treasury auction. If there is growing interest in the de-dollarisation story, foreigners (who own around 25% of the outstanding Treasury supply) perhaps do not roll maturing Treasury holdings into new issues. The focus therefore will be on the indirect bid at the auction and also the general gauge of auction success, such as the bid-to-cover ratio and the tail. A poor auction could rekindle the weaker dollar story, where a pair like USD/JPY could lead the dollar lower in a more difficult environment for risk.

Ahead of the auction, the only data is the NFIB Small Business Optimism Index for May. Having very much welcomed President Trump's election, this community has been hit hard by tariff uncertainty. A small bounce in optimism is expected today, but probably not enough to move the dollar.

There doesn't seem to be a big catalyst for DXY to move outside a tight 98.80 to 99.40 range today. However, look out for any updates on US-China trade talks. Any good news is probably a dollar positive in the current environment.

Chris Turner

EUR: Bull trade needs feeding

Traded EUR/USD volatility levels are a little softer as spot continues to sit well within range confines. As above, it costs investors around 2.5% per annum to sit with a long EUR/USD position. Thus, those bullish on EUR/USD need to be fed some bad news on the dollar. That potentially could come with tonight's US Treasury auction results, but is not a given.

In terms of the eurozone calendar today, we have the Sentix Investor Confidence reading for June and a speech from Austria's Robert Holzmann, who was the sole dissenter against last week's 25bp ECB rate cut. It's hard to see EUR/USD breaking out of a 1.1370-1.1430 range today, with directional breakout risks equally balanced.

Chris Turner

GBP: Dovish tilt to today's UK labour market data

Sterling is fractionally softer on this morning's UK labour market data for April and May. Here are the thoughts of ING's UK economist, James Smith: "On the face of it, it is a fairly dovish UK jobs report this morning. Wages are down more than expected – private sector at 5.1% YoY. These were due to come lower anyway as a result of base effects, but this is a bigger drop. More eye-catching is the sharp fall in payrolled employees at -109k. That would be the biggest monthly drop outside of the Covid-19 pandemic since the data series began in 2014. But this data always gets revised, and more often than not, it is revised up. For example, in March, the initial reading was -78k, and it has since been revised to -35k. Still, there is clearly a more negative flavour to these numbers over the past few months, and it reinforces the need to keep cutting rates, else the Bank of England risks slipping behind the curve."

This softer data comes at a time when sterling's relatively high yield is in demand. It has, however, triggered a 20 pip rally in EUR/GBP to 0.8435 and could prove a reminder that the BoE is well behind the ECB in its easing cycle, and the policy spread may narrow some 100-125bp against sterling over the next 12-18 months. 0.8445/60 looks like important short-term resistance for EUR/GBP.

Chris Turner

EM: From Brazil to Hungary, carry is favoured

EM currencies have been doing pretty well recently. And the better performers have come from Latin America and Central Europe. Looking around the world, implied yields through the one-month forward stand at: Brazil, 14% p.a, Mexico, 8%, South Africa, 7%, Romania 7% and Hungary 6%. So in quiet markets, it seems investors are prepared to overlook the clear fiscal challenges in Brazil, Romania and Hungary and opt for the carry.

It would also not be a surprise to hear that the National Bank of Romania is now intervening to buy EUR/RON and replenish its FX reserves after all the intervention it took to protect the leu during the recent presidential elections.

Subdued US price data this week should retain interest in these EM high-yielders. The CEE region, however, will closely track tomorrow's No-Confidence vote in the Polish parliament, where PM Donald Tusk's ruling coalition seems confident of victory.

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