FX Daily: King dollar, queen krona

The dollar is finding more strength thanks to a soft risk environment and attractive real rates after the bond selloff. We now see downside risks for EUR/USD potentially extending to 1.02 in a bond sell-off acceleration. SEK is emerging as a big outlier, and we suspect Riksbank FX hedging is behind that, watch for action around 10:00 am BST this morning

USD: Unstoppable strength

The dollar is enjoying another widespread rally, shrugging off yesterday's unconvincing US consumer confidence figures while being boosted by a round of defensive re-positioning amid a deteriorating risk environment. Furthermore, the recent treasury selloff has kept fuelling the real rate attractiveness of the dollar, reinforcing the greenback's role as the go-to currency in the current market's environment.

Federal Reserve speakers have also thrown some hawkish comments into the mix. Neel Kashkari confirmed his notably hawkish stance saying that one more hike is needed even in a soft-landing scenario, and Michelle Bowman has also pointed in the direction of more tightening. Market pricing has, however, remained stuck in a less hawkish position than the recent dot plot projections – less than a 50% chance of another hike this year and the effective rate being cut to 4.67%.

So, there are two lingering upside risks for the dollar stemming purely from the rate market: one being generated from higher longer-dated yields, one from a potential hawkish repricing of short-term rate expectations upholding short-term swap rates. We discuss those risks from a EUR/USD perspective in this article, where we conclude there is more room for a USD rally coming from back-end treasury underperformance rather than another big move in USD short-term swap rates. That's because the gap between the December 2024 Fed Funds rate market pricing and the 2024 dot plot is much smaller compared to what it was back in June (and throughout the summer).

Today, the US calendar includes durable goods orders for the month of August and another speech by the arch-hawk Neel Kashkari. Fed Chair Jerome Powell will participate in a town hall tomorrow, although it is unclear whether he will touch upon monetary policy issues. The next level to watch in DXY is the 106.82 November 2022 highs, although we have seen the index rise comfortably through key levels, and upside risks now extend to the 107.00/107.50 area should the US bond market sell-off accelerate further.

Francesco Pesole

EUR: 1.0200 is the outside risk bottom

In the article mentioned above, we estimate that an extension of the run in US treasury yields to the 5.0% mark would take EUR/USD to 1.02. That is not our base case, but the ongoing pressure on the euro is clearly not confined to the US rates story. The ongoing re-rating of growth expectations in the eurozone has ultimately come through to the FX market and taking a toll on the common currency.

Developments in the US activity story remain much more important, and if signs of weakness emerge across the Atlantic (and markets price in more Fed tightening) we expect a swift turnaround in EUR/USD, but that may not be a story for the near-term. Holding at the key 1.0500 support will be a success for those hoping for that turnaround to happen anytime soon.

Today, the eurozone calendar is light until tomorrow's CPI figures start to come in, and there are no scheduled European Central Bank (ECB) speakers after Austrian hawk Robert Holzmann said it was unclear whether the peak in rates had been reached yesterday.

Across the British channel, the economic calendar is also looking empty today, with no scheduled central bank speakers. We continue to flag downside risks to the 1.2000 area in Cable, while EUR/GBP may struggle to hold on to recent gains as sterling's recent underperformance relative to the euro starts to look a bit overdone now that the big bulk of the Bank of England repricing has happened.

Francesco Pesole

SEK: Riksbank propping krona ?

The Swedish krona has been a big outlier since the start of the week, strengthening for two consecutive sessions while all other G10 currencies fell against the dollar. While the positive developments on the SBB saga have likely helped compress the EUR/SEK risk premium, that seems insufficient to justify such outperformance, especially considering the krona's high beta to risk sentiment, which has been soft.

It appears instead that the Riksbank's start of hedging operations is having a substantial impact on the market. For context, the Riksbank announced last Thursday that it would hedge part (USD 8 billion and EUR 2 billion) of its FX reserves in a risk-management move aimed at reducing losses in the event of a krona appreciation. Unlike other measures of this kind, the Bank did not release a schedule for purchases but only said that the operations would take four to six months, the sales "will be adjusted to market conditions to avoid counteracting the Riksbank's objectives" and weekly sales data will be published with a two-week delay.

We saw two sharp drops in USD/SEK and EUR/SEK in the past two sessions shortly after 1000 BST in Monday's and Tuesday's session. We'll be on the lookout today for a similar move around that time today, as that may be a signal that the Riksbank is conducting its daily sales operations around that morning timeslot.

The Riksbank stressed this is not FX intervention or a monetary policy tool but mere risk management. The lack of transparency around the amount of weekly sales means the Bank can sell larger amounts at higher USD/SEK and EUR/SEK levels and then justify this as a mere loss-minimisation approach (buying more SEK when it is cheaper).

For now, it seems like the wanted or unwanted beneficiary effect on SEK is working. We still point at some upside risks in the near term for USD/SEK and EUR/SEK, especially once markets adjust to the Riksbank being present in the FX market, although now there is definitely value in holding SEK against other high beta pro-cyclical currencies like NOK.

Francesco Pesole

CZK: Last discussion before rate cuts

The Czech National Bank (CNB) will meet today to make its latest monetary policy decision and we believe it will be the last meeting before it begins to discuss the real possibility of rate cuts. This time there is no new central bank forecast and the board will only discuss an internal update on the situation. Our forecast remains unchanged – a first 25bp rate cut in November alongside a new central bank forecast. The main question today will therefore be whether the governor will indicate when to expect the first rate cut or leave no clues.

EUR/CZK is gradually sliding down with the market seeing that the CNB will not follow the NBP's actions. While it is clear that a rate cut is around the corner in the Czech Republic, we expect the board to adopt a cautious approach, which should support the koruna and erase losses after the sell-off triggered by the central bank's steps in Poland in early September. Thus, we expect EUR/CZK to end today safely below 24.40.

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