

FX Daily: Looking beyond the bond sell-off

Today's US jobs data release may well keep the volatility in long-dated US bond yields elevated. Such volatility remains relevant for FX, but implications of payrolls for Fed pricing are what matters most for the dollar beyond the very short term. Watch for important jobs data releases in Canada too: a September Bank of Canada hike hangs in the balance



➔ USD: Time to re-focus on Fed pricing?

US bonds remained under pressure yesterday due to the toxic combination of resilient US activity indicators, rising supply, and the impact of Fitch's downgrade. It does appear like a rather unique combination of factors which has generated a bearish pocket, and questions about the sustainability of the sell-off are rather appropriate. If the dollar is to rally much further, we doubt it can be on this basis.

Markets may have not paid enough attention to the details of yesterday's [ISM service figures](#) amid the bond turmoil. While the decline in the headline survey was only a tad larger than expected (52.7), and still in expansionary territory, the employment component slowed quite sharply, from 53.1 to 50.7. The ISM manufacturing employment gauge is at the lowest level in three years and those two surveys alone could tell us the risks are slightly skewed to a softish read in non-farm payrolls today. That is unless the ADP figures start having any real predictive power of official jobs

data, which they haven't had in recent times. The 200k consensus call seems consistent with recent indicators, but unemployment may inch higher. Wage growth will attract a good deal of the Fed's focus this month.

The US sovereign credit downgrade and the rise in long-dated US yields have supported the dollar, especially against higher-beta currencies. As per above, that appears mostly due to temporary factors, and the dollar's short and medium-term outlook continues to hinge predominantly on Fed expectations, which have remained untouched amid the recent bond selloff. Markets enter today's NFP release pricing with very little chance of any further hikes (8bp) and placing the first rate cut in May 2024.

This market positioning leaves non-negligible room for repricing in either direction (pricing in a hike before year-end, bringing forward the first cut), so out-of-consensus NFP prints should trigger sizeable directional moves in USD crosses. Incidentally, elevated volatility in longer-dated yields should see that part of the curve move quite sharply after the release, and continue to be a factor for FX today. Still, once the fiscal and bond supply factors dissipate, hard data are what investors will be left with, and what can dictate moves beyond the very near term.

We follow with interest two currencies that have become cheaper in this risk-off rout: NZD and CAD. The former seems close to maxing out on the negatives it can factor in, having already absorbed the Reserve Bank of New Zealand's (RBNZ's) dovish turn, poor domestic data and China's growth pessimism. A stabilisation in sentiment and return of interest for carry trades can offer breathing room for the high-yielding NZD, and we don't dismiss that the RBNZ will need to re-consider tightening on the back of an inflation rebound later in the year.

When it comes to CAD, there are important jobs numbers being released today that we think have the potential to tilt the balance towards another rate hike in September. The consensus is for a 25k employment increase, less than half the 60k June figure: we'd not be surprised to see a stronger print. Wage growth should inch higher and that can be enough to push markets towards pricing in one last rate hike in September (currently 8bp priced in).

Francesco Pesole

➔ EUR: Stabilising

The EUR/USD decline stalled around 1.0910 yesterday and the pair has found some support overnight in line with a broader unwinding of safe-haven positioning. The euro was more shielded than higher-beta currencies at the peak of the bond turmoil and also has more limited scope for a rebound once pressure on bonds eases.

With the eurozone calendar being very light, EUR/USD moves will entirely be determined by US jobs data and any more swings in treasury yields today. Any sub-consensus read should see a return to 1.100+ levels, while stronger-than-expected numbers would drag the pair to the next key supports at 1.0900 and 1.0850.

Francesco Pesole

➔ GBP: A hawkish 25bp hike by the BoE

The positive inflation surprise ultimately led to a lack of major surprises at the Bank of England policy announcement yesterday. Despite market pricing modestly exceeding 25bp, a pre-meeting

drop in the pound and the hawkish message attached to the 25bp hike left the currency broadly unchanged after the announcement.

As discussed in our [BoE meeting review note](#), there are signs of growing dissent within the MPC, as two members voted for a 50bp increase and one for a hold. However, the Bank's forecast now indicates that inflation is expected to return to target by 2025, also under the assumption the Bank rate isn't hiked further over the coming months.

The BoE is understandably leaving the door wide open for more tightening, and markets are currently betting 5.75% will be the peak rate. Our economics team's view is that another 25bp increase to 5.50% in September is likely, but that may well be the end of the cycle as inflationary pressures abate. This leaves room for a rebound in EUR/GBP to the 0.87-0.88 area by year-end, although our view that the dollar will decline towards the end of the year means Cable can still trade above 1.30 in the fourth quarter.

Francesco Pesole

📌 CZK: CNB formally ended the FX intervention regime

At [yesterday's meeting of the Czech National Bank](#), rates remained unchanged as expected. However, the main surprise came from the decision statement itself, which announced the formal end of the FX commitment. Although the Czech National Bank (CNB) last intervened in October last year and the charges were still very high, the board felt it was no longer necessary to raise the possibility of FX intervention any further.

Technically, this decision does not change anything, as the Czech koruna is a managed float regime, so the central bank can intervene at any time, which was confirmed by the governor later during the press conference. At the same time, the central bank has resumed the programme of selling FX reserve proceeds, which is meant to prevent further growth of the central bank's balance sheet, which has been criticised in the past as a legacy of the previous board.

However, volumes under this programme have reached €100-200m per month in the past, which should not have a visible effect on the market. Although the governor reiterated that FX remains an important tool in the fight against inflation, it seems that the Board wanted to test the market before the actual rate cut and also perhaps work off some monetary easing before the actual rate cut. Our forecast remains unchanged, with the first cut in November.

In the FX market, the Czech koruna reacted by weakening by a jump to 24.20 EUR/CZK, which seems to be not such an aggressive reaction given the surprise from the central bank. So on the one hand we would expect further depreciation today, on the other hand it is not sure if the central bank is already active in selling FX reserve proceeds and thus preventing a sharp depreciation. Of course, the governor did not want to comment on this issue and it would not be good news for the CNB. Thus, we expect to see further pressure on the koruna today and do not rule out another move to 24.30-40 EUR/CZK to test new highs in the market.

Frantisek Taborsky

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Chris Turner

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

chris.turner@ing.com

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