FX Daily: More signs of pre-election deleveraging

The dollar is finding more support at the start of this week as US Treasury yields jumped. While some hawkish Fedspeak has contributed to the move, we suspect we are seeing more signs of some deleveraging ahead of the closely contested US election in two weeks; a dynamic that we see supporting the dollar across the board

USD/JPY remains a closely watched pair after breaking again above 150.0

USD: Strengthening its position

The US Treasury selloff is adding fuel to the dollar rally. Our perception is that the size of the bond and FX moves are now being exacerbated by some deleveraging ahead of the US election. The path should be a stronger dollar if FX liquidity conditions indeed worsen into 5 November, and we could see the Norwegian krone emerging as a big underperformer due to its low liquidity character. We still expect some additional pressure on AUD and NZD as market hedges for a Trump re-election can hit China proxies.

Yesterday, three Fed speakers (Logan, Kashkari and Schmid) sounded quite cautious about future easing, effectively endorsing the recent hawkish repricing in the USD OIS curve. Mary Daly was more dovish, but that did not prevent markets from trimming another 5bp from year-end rate expectations. The Fed Funds futures curve currently embeds 40bp of cuts and the OIS curve 36bp.

While that has continued to widen to policy divergence in favour of the dollar, we are not sure markets will be willing to price out much more easing without having first received some further information on the jobs market. In that sense, we may need to wait another week (JOLTS job opening figures on 29 October) for the next key input to the macro story. Until then, our bias for a stronger dollar is more a result of potential Trump hedges rather than further near-term swap rate widening.

Francesco Pesole

EUR: Watch for ECB speakers today

The recent (implicit) shift towards growth concern in the ECB narrative automatically places a greater focus on activity surveys like this week's PMIs and Ifo, which have previously been overlooked by the Governing Council. But before then, we'll get a chance to hear from a long list of ECB speakers. Today, along with a TV interview from President Christine Lagarde herself, we'll hear from doves Panetta and Centeno, neutral members Villeroy and Rehn, and hawks Knot and Holzmann.

It is quite common for ECB members to fine-tune the policy message in the period after a rate decision. The key question is: are the hawks fine with Lagarde's sanguine disinflation view, a gradual shift in focus to growth and such a dovish market pricing? Given some lingering pockets of sticky services inflation in the eurozone, the answer is probably no. But unless PMIs show some sign of life on the activity side, convincing markets to price out some easing will be no easy task. Naturally, should we see signs of faltering resistance towards easing by arch-hawks like Knot and Holzmann today, expect the euro to feel some additional pressure. Yesterday, hawkish member Kazimir said the December decision is "wide open", quite a dovish shift from his pre-October meeting comments.

In the rest of Europe, we'll be keeping a close eye on the first of four speeches Bank of England Governor Andrew Bailey is set to deliver this week. EUR/GBP has room to rebound from 0.8300 as markets may prove rather sensitive to any dovish hint by Bailey, and also considering some pre-UK budget positioning can see some buildup of GBP shorts. Looking at GBP/USD, our near-term bias remains 1.28.

Francesco Pesole

JPY: Political risk mounting

USD/JPY remains a closely watched pair after breaking again above 150.0. The yen is naturally highly exposed to bond market weakness, but markets are also adding some political risk premium into the yen after the latest polls showed the ruling LPD-Komeito coalition losing support ahead of this week's election. Political weakening of Prime Minister Shigeru Ishiba can lead to a further delay in the Bank of Japan normalisation plans, leaving the Minister of Finance with the decision to either leave the yen to give in to further selling speculation or jump back into FX intervention.

We still think markets will be more sensitive than in previous instances to verbal intervention given the success of the latest round of FX intervention, but for now there is a good chance JPY speculators will keep testing which new level will trigger an MoF reaction.

USD/JPY easily broke through the 100-day moving average at 150.7 yesterday. We'll see whether the 200-day MA 151.3 level offers some better resistance. Lacking some reaction from Japanese authorities, the combination of a stronger dollar and Japan's political risk premium can take

USD/JPY back to the 153-155 mark before the US vote.

Francesco Pesole

CEE: Hungarian central bank tries to support the forint again

Yesterday's data in Poland brought a downside surprise across the board. This morning we have already seen Hungarian wages for August and later on retail sales in Poland will be released which we expect to be above the market's expectations.

However, today's highlight is the National Bank of Hungary meeting. In line with expectations, we expect no change in rates at 6.50%. Of course, the recent sell-off in HUF, along with the whole EM space, has turned the central bank hawkish and the pause in the cutting cycle has been highly communicated in the previous days. Even so, the market awaits another hawkish report and hints as to what central bankers want to see before returning to the rate cut discussion.

On the macro side, the central bank may be satisfied. Inflation is on target while the economy surprises more on the negative side. However, global markets are not supportive and EUR/HUF above 400 is a warning sign for the NBH. The main question for today is how long the pause in the cutting cycle is.

Markets have priced out much of the NBH easing and rates continue to sell off across the IRS and HGBs curve. The market is pricing in the first cut in June after yesterday with the terminal rate at 5.90%, roughly 130bps above the September lows. That seems too far to us, but it makes no sense to go against the market in this environment. Despite the market already being on the hawkish side, NBH will not have an easy job today and communication will be key. However, we believe the central bank is aware of the fragile situation and therefore the HUF could see some gains today, but it is probably too early for any significant recovery and every gain could be short-lived.

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