

## FX Daily: One last quiet day

This will be the last day of relative calm in markets, ahead of two days packed with big central bank action. Investors are holding on to the dollar into the Fed, which signals expectations for a hawkish hold, while the euro is finding some modest support from speculation of ECB addressing excess liquidity. Canadian CPI may put a BoC hike back on the table



The FOMC two-day meeting begins today. Pictured: Fed Chair, Jay Powell

### ➔ USD: Positioning consolidates in favour of dollar ahead of key events

Investors are consolidating their positions ahead of a slew of risk events for markets this week. This will be the last quiet day before the action begins with the Fed meeting and UK CPI tomorrow, and then four central bank meetings in Europe (in chronological order: Sweden, Norway, Switzerland, UK) on Thursday.

The dollar traded a little softer in yesterday's afternoon session but has remained close to the March highs (DXY has stayed above 105.00). The rally in oil prices – Brent at \$95/bbl – has been helping the dollar, both because the US is a net oil exporter and because it adds an argument against turning too optimistic on US inflation. It appears markets are happy to hold on to recently built dollar longs ahead of tomorrow's FOMC, which suggests expectations are generally for a

hawkish hold.

CFTC data show that the net dollar positioning has increased for eight consecutive weeks and has now moved into net-long territory. Speculators remain net-long EUR/USD at +15% of open interest as of last week, which was however the lowest level since October 2022. That may cap the upside potential for the dollar, but as discussed in our [Fed preview](#), there should still be enough in the dot plot projections to keep the dollar supported.

Today, the US calendar includes housing starts and building permit figures for the month of August, which are unlikely to impact markets. DXY should keep trading close to 105.00 into the Fed.

Francesco Pesole

## ➔ EUR: ECB addressing excess liquidity?

The start of the week has seen EUR/USD rebound modestly and attempting to climb back above 1.0700 after the ECB-driven sell-off had EUR bears setting their eyes on the 1.0520 March lows. It's not inconceivable we'll test the 1.050/1.0550 area: a hawkish Fed can hurt the global risk environment, and more resilience in US activity data endorse the higher for longer narrative.

On the ECB side, it was reported yesterday that the ECB is planning to discuss how to deal with banks' excess liquidity and is apparently considering raising reserve requirements. That would be a de-facto additional tightening, so the euro was slightly stronger on the news, but hardly enough to turn the tide for EUR/USD as the pair remains depressed on a wider Fed/ECB rate differential.

Markets remain highly doubtful the ECB will deliver any additional rate hikes after the dovish tilt in the statement last week: the implied probability of another 25bp hike is less than 30%. Attempts by some ECB members to fine-tune the policy message to the hawkish side have not been successful. Markets are data-dependent at this stage, for the Fed and for the ECB, and out-of-meeting communication seems to have limited the ability to influence rate expectations. Yesterday, Bank of France Governor Francois Villeroy hinted that 4% should indeed be the peak in rates.

The eurozone calendar today only includes the final print of the August CPI figures. It's also worth keeping an eye on the OECD Economic Outlook, which will be published this morning and can have some modest market impact.

Francesco Pesole

## ➔ GBP: Underperforming into the BoE

The pound has been the worst-performing G10 currency in the past 30 days, and Bank of England members' dovish comments are surely to blame. We are not surprised to see investors staying broadly defensive in FX ahead of tomorrow's CPI figures and Thursday's BoE announcement. The data has not pointed clearly in the dovish direction, but BoE communication has (compared to previous expectations), so even evidence of lingering price pressures tomorrow does not guarantee a hike on Thursday.

We discuss why the BoE might keep rates on hold and what would be the impact on sterling [in this note](#). Our base case remains a rate hike, although the upside for sterling would entirely depend on

whether the BoE will convince markets they can do more (a similar situation to last week's ECB meeting) since the Sonia curve prices in 38bp of tightening in total, even if they attach only an 80% implied probability of a hike on Thursday.

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## CAD: Inflation data important after strong jobs numbers

The second quarter growth figure shock seemed to have put an end to the Bank of Canada's mid-2023 tightening reboot. The BoC did leave the door open for more hikes if needed on 6 September, but the deterioration in the economic outlook and less concerning inflation picture all pointed to an extended pause.

The August jobs figures were, however, very strong: a 40k employment jump (twice the consensus number), an unchanged unemployment rate after three consecutive months where it inched higher, a big rise in full-time hiring and accelerating wage growth. With gasoline prices having risen, headline inflation is expected to have accelerated from 3.3% to 3.8% in August. Markets and the BoC will look at the trim and median measures, which are seen stabilising around 3.7%.

Any upside surprise in the inflation figures would likely put a BoC rate hike back on the table, even though it is not our base case at the moment to see another BoC move. Markets are pricing in 15bp to a peak, and we could see that being pushed to 20bp or higher after a strong CPI read today. Given its stretched overvaluation, we had been calling for a correction in USD/CAD for a while: the pair is reconverging (i.e., dropping) with short-term fundamentals now, and a potential post-CPI rally could see it slip further to 1.3400.

Francesco Pesole

### Authors

#### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

#### Chris Turner

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

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

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