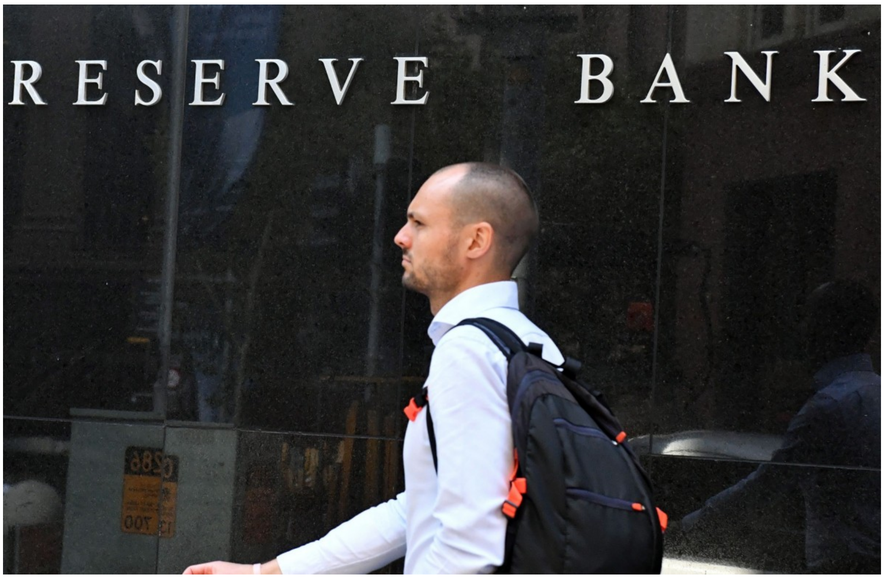
FX Daily: One more hawkish shift in G10

Overnight, the RBA abandoned its yield-curve-control policy and changed forward guidance to 2023. That was enough to curb more hawkish bets and weaken the already oversold AUD, which however seems likely to recover in the short term. Ahead of tomorrow's FOMC, USD volatilility should stay low, but keep an eye on moves in ILS, CHF and SEK.



USD: Quiet build-up to tomorrow's FOMC

The dollar started the week on the soft side, mostly against European low-yielders (CHF, EUR, SEK) and partly against G10 commodity currencies, which marginally benefitted from rising oil prices after yesterday's report that OPEC+ added only half of the barrels planned for October. On the data side, fairly good ISM Manufacturing numbers yesterday, slightly above consensus, had limited market impact.

The data calendar is empty in the US today, and some wait-and-see approach ahead of tomorrow's FOMC meeting may keep dollar volatility subdued. Some headlines may start to come in from Glasgow where the COP26 meeting has kicked off, although unlikely to have major market impact in such an intense week for central bank activity.

EUR: Back above 1.1600, but CHF and SEK are more interesting markets now

EUR/USD is back above 1.1600 as the set of European low-yielders seemed to receive some lift yesterday. Wider moves were again seen in CHF and SEK. The former has been strengthening significantly of late after a widening in European peripheral spreads and also possibly due to speculation that the SNB will reduce FX interventions. On this topic, the Treasury FX Report is due any day now (it is normally published mid-October), and we estimate that Switzerland has continued to meet all criteria to be labelled a currency manipulator, although we think the country will be spared the manipulator tag again. Our view is that the SNB will increase interventions to defend EUR/CHF at 1.0500.

When it comes to SEK strength, that appears to have been fuelled by market speculating that the Riksbank will not be able to hold on to its promise to keep rates at 0.00% for much longer, and 50bp of tightening are now fully priced in for the next 12 months. We think the Bank will strongly push back against such hawkish expectations at the 25 November meeting, but there may not be clear catalysts to trigger a major correction in SEK until then, and EUR/SEK may stay around or modestly below 9.90 for most of November.

AUD: Unable to benefit from RBA's hawkish turn

The RBA scrapped its 10bp target on the April 2024 bond overnight, a move that was fully priced in by the rate market. We think it may have been the market itself – with its speculative bearish bets on short-end rates – that forced the RBA to drop YCC, hence it was no surprise to see the Bank push back on rate expectations that saw 80bp of tightening in the next 12 months right before the meeting. The new forward guidance is for late 2023, although Governor Philip Lowe clearly stated in the press conference that there is high uncertainty over the timing of the first hike and that there is still a high chance that the Bank will have to wait until 2024.

Unlike other central banks (like the ECB recently), the RBA's message was successful in at least marginally scale down hawkish bets, although markets are still pricing in 76bp of tightening in the next 12 months. In FX, some respite in short-term rates send the Aussie dollar lower overnight. There is still clearly a gap between AUD and Aussie rates, with the former that saw a relatively small jump as rates sold off last week and now seems to be over-discounting the post-RBA correction in yields. We struggle to see this dislocation as sustainable, especially considering that CFTC data continued to show a very short positioning on AUD. We think short-term risks are skewed to the upside for AUD and the RBA's updated forecasts due on Friday might be the trigger for a correction up in AUD/USD.

ILS: BoI waves the red flag to Shekel bulls

Despite the BoI in October promising accommodative monetary policy for a 'prolonged time', it has come as somewhat of a surprise that the BoI has pulled away from intervening in USD/ILS at 3.20. Recall that in January, the BoI said it would spend up to $30bn, potentially more, to fight Shekel strength.

So, what's changed? Israel has weathered the fourth wave of Covid-19 very well, with 2021 growth expected at 7% and 2022 at 5.5%. October CPI came in at 2.5% YoY and, through the capital markets, 5-10 year inflation expectations are running at 2.2% - the highest since 2016. Having suffered long periods of deflation, the tide might now be finally turning in Israel.

Additionally, having long sought to protect exporters, we wonder whether the BoI, like the PBOC, has shifted to protecting importers during a period of high commodity prices – a new development we discussed last month.

The BoI retreating from intervention at 3.20 has seen USD/ILS drop sharply to the 3.11 area, where BoI presented its new intervention budget in January. Breaking below 3.10 would be a surprise and having been so interventionist for so long, we would be shocked were the BoI to let USD/ILS trade below 3.00 this year.

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