

FX Daily: Perfect storm drives dollar stronger still

The dollar continues its relentless grind higher, buoyed by factors like the repricing of the long-term Fed funds rate, high oil prices, and concerns over the direction of travel for both the European and Chinese economies. In theory, the prospect of a US government shutdown should be a mild \$ negative - but it will probably take more to turn this trend



The relative strength in US activity indicators has kept the dollar in demand over the past few weeks

USD: The low-point in the next Fed easing cycle is priced at 4.3%

The dollar remains very well bid and has rallied around 7% from its low point in mid-July. Corrections have been few and far between - largely because of a confluence of factors. At the heart of it is strong US growth and a Federal Reserve that is showing no signs of letting up its [hawkish rhetoric](#). And increasingly, the market is building the view that the next Fed easing cycle - whenever it comes - will not be the kind of 300-400bp affair we have been used to over prior decades. This has lifted the market pricing of the low point for the next Fed easing cycle - priced in around three years - to 4.29%. This was just at 3.99% last Friday and around 3% in the spring. This

has been a key factor driving long-end US rates higher. 5.00% on the US 10-year Treasury yield is the [bias from our rates strategy team](#).

At the same time, higher crude oil prices, as Saudi supply cuts keep the market in deficit, are driving a renewed wedge between the 'haves' - the US - and the 'have nots' - Europe and Asia. Our commodities team sees the risk that Brent crude [briefly spikes above \\$100/bbl](#).

Add in developments in Europe and China, and one can see why the high-yielding dollar remains in demand. For Europe, we would highlight two new euro negatives this week - Italy pushing the budget boundaries and some European Central Bank officials discussing large rises in Minimum Required Reserves. And in China, the news out of the property sector remains bleak.

We have been saying for a while that a softening in US activity data is required to turn the dollar around. But because of the poor investment outlook overseas, that bar for poor US activity data is now higher. On that subject, today sees the weekly jobless claims. These have been really robust. We also see the 3Q23 PCE deflator.

In theory, a US government shutdown should be slightly dollar-negative in that it provides a [hit to activity and not to US creditworthiness](#). But it is going to take a lot to turn the dollar and it could well stay bid into mid-October when US corporates in California need to pay their taxes. DXY looks like it can grind to 107.00/107.20 and perhaps the biggest threat to the dollar is the Bank of Japan selling \$20-30bn near 150 in USD/JPY as Japanese officials watch FX 'with a strong sense of urgency'.

Chris Turner

📉 EUR: Some new negatives

EUR/USD near 1.05 would suggest that a lot of confidence has been lost in the euro. Yet the European Central Bank's trade-weighted euro is just 2.5% off its July highs. We can probably all agree that the dominant trend is a strong dollar. However, two developments this week warn that the euro may be due some independent weakness. The first is the suggestion from some ECB officials that Minimum Required Reserves for European banks need to be raised - perhaps substantially. Our banking specialists in research feel that such a move would hit [banking liquidity at a crucial juncture](#) and no doubt weigh further on already soft bank lending. We think an MRR hike would be a clear euro negative.

Additionally, another emerging story this week is the Italian BTP- German Bund 10-year spread widening out to 200bp as the Italian government announces looser fiscal policy. This will put the issue of the return of Maastricht fiscal criteria back in the spotlight for early next year and will be a factor worth assessing for whether it puts a renewed risk premium back into the euro.

Based on the above, there seems no reason to fight this bearish EUR/USD trend just yet. But for today, keep a look out for German and Spanish inflation - in case it builds momentum for one last ECB hike. If not, expect EUR/USD to continue drifting to the 1.0400/0410 area.

Elsewhere, the Czech National Bank (CNB) has laid out its strategy for its forthcoming easing cycle - [a cycle we expect to start in November](#).

Chris Turner

➔ GBP: Caught in the crossfire

Like the euro, sterling has probably been caught in the crossfire of position adjustment. Speculators had been trying to hold onto long euro and sterling positions through the spring, despite the strengthening dollar. Presumably, these positions have now been cut. Like EUR/USD, GBP/USD remains vulnerable to the 1.20/21 area.

Chris Turner

⬇️ MXN: September correction continues

High US interest rates are proving a headwind to emerging currencies worldwide - even to the mighty Mexican peso. In addition, the peso this month is facing the unwind of Banxico's FX intervention book - a front-loaded exercise that [we felt could weigh on the peso this month and perhaps into October, too](#). With the dollar set to stay strong for the next few weeks, USD/MXN could head up to the 200-day moving average at 17.85 or even briefly trade above 18. However, we like the peso multi-quarter and expect good peso buying interest should USD/MXN trade over 18.

Today also sees Banxico announce its latest monetary policy decision. No one expects a change in the 11.25% policy rate. And with US rates so high, it seems too early for Banxico to start entertaining speculation of an easing cycle. This month, the market has priced out 125bp of Banxico easing over the next two years. However, the market still has 200bp of easing priced in. A little more could be taken out of market pricing for the easing cycle today - but not much.

Chris Turner

Authors

Chris Turner

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

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s).

as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.