

FX Daily: Re-pricing for a world of higher US rates

FX markets are settling down after a big week of central bank policy announcements. Perhaps the biggest story is that the world's 10-year benchmark borrowing rate is pressing at 4.50% – seemingly on the view that a new neutral rate for Fed Funds may be 4%, not 2.5%. Expect the dollar to hold gains as Europe braces for another soft run of PMI data



USD: 4.50% on the US 10-year yield could pressure risk assets

US interest rates continue to grind higher. Overnight, the US 10-year Treasury yield has edged up to 4.50% – the highest since 2007. Driving the move continues to be a re-assessment of the Fed's higher-for-longer policy. Looking out along the USD OIS curve, investors struggle to see short-term US rates (one month OIS) below the 4.00% area over the next 15 years. Our rates strategy team argues that it is fair to see a modest positively sloping yield curve over that period and the 10-year priced 50bp above this 4% low point.

This grind higher in US yields – marking higher risk-free rates – creates headwinds for risk assets

such as equities, credit and emerging markets. Indeed, even the AI-powered S&P 500 is having a bad month, though it is still up 12.8% year-to-date. This equity correction is supportive news for the dollar, where any move to cash will mostly end up in the liquid dollar that pays 5.30% overnight rates.

For today, another bleak run of PMIs in Europe may well keep European currencies soft and the dollar bid. The US data calendar today sees the flash PMIs for September, where the composite PMI remains just above 50. This data has not been market-moving recently. More important was yesterday's release of the lowest weekly jobless claims since January which suggested there are very few signs of a robust US labour market turning.

Expect DXY to remain bid and there is a scenario where the dollar stays strong into mid-October, when large US corporates based in California need to pay their taxes.

Chris Turner

⬇️ EUR: More pain from the PMIs?

EUR/USD remains under pressure as dollar strength dominates. The euro faces an event risk from today's releases of the flash PMIs for September. It really has been the PMI releases that have hit the euro since the summer. Despite all this pessimism about the euro, however, the ECB's trade-weighted euro is only 2% off its highs in July. This can probably be read as both the strong dollar being the dominant story and the eurozone's trading partners (Europe and China) faring as poorly as the eurozone.

For EUR/USD, an imminent turnaround looks unlikely and support at 1.0600/0610 looks the last barrier before what seems the more likely dip to the 1.05 area. As discussed in the Swiss National Bank (SNB) [review](#), the dovish turn from the SNB did not do too much damage to the Swiss franc since the SNB is still selling FX. Expect EUR/CHF to get back to 0.95 over the coming months.

Chris Turner

Elsewhere, both the Riksbank and Norges Bank hiked by 25bp yesterday, in line with expectations. The Riksbank signalled close to a 50% implied probability of another hike in its rate projections, matching market pricing. The Governor said there is a high probability of more hikes, but there seems to be low conviction within the Board. As discussed in our [meeting review](#), this was a missed opportunity for policymakers to deliver real support to the krona, which averted a slump only thanks to the announcement that FX reserves will be hedged. Please see the background on that topic [here](#). SEK remains vulnerable in the near term, and EUR/SEK can break the 12.00 ceiling soon.

Norges Bank [was more hawkish](#), as it explicitly signalled another hike should be delivered in December, although that should be the last one. EUR/NOK was only modestly offered and remains tied to the 11.50 level: a confirmation that a NOK rebound (or further depreciation) relies almost entirely on external factors.

Francesco Pesole

➡️ GBP: Most of the short-term repricing is done

It was not our baseline view, but we did warn that EUR/GBP could hit 0.8700 yesterday if the Bank of England paused, and that is what happened. As our UK economist, James Smith, discusses in his

[BoE review comment](#), we think the terminal rate has been reached now at 5.25%. However, given that it was such a close vote yesterday (5-4) there is still a chance of one final hike at the 2 November BoE meeting. This means that the market pricing of around a 50% chance of one last hike may largely stay with us until that meeting.

Pricing of the BoE curve has been a big driver of sterling this year and we suspect EUR/GBP can now drift in a 0.86-0.87 range into that meeting. A leg higher to 0.88/89 probably requires some news of a serious UK slowdown and the market moving on to pricing the 2024 easing cycle.

GBP/USD is another matter, however. If EUR/USD trades down to 1.05, GBP/USD could be trading near 1.21.

Chris Turner

➔ EM: Good news for India, bad news for Egypt

The financial institutional (FI) community take a keen interest in the make-up of key benchmark indices, and the big news overnight is that Indian local currency government bonds will be included in the JPMorgan GBI-EM index from June next year. Some estimates put inflows into these bonds as much as \$25bn as passive tracker funds make their adjustment. We know as well that some in the FI community like the Indian rupee (INR) carry trade, where the three-month implied yield through the non-deliverable forward market is 7%+ annualised. The view here as well is that the Reserve Bank of India is an active intervener and will be seeking to cap USD/INR in the 83.00/83.30 area. Expect this JPMorgan index announcement to spark more interest in the rupee.

At the same time, JPMorgan put Egypt on negative watch for possible removal from the GBI-EM index, because investors were struggling to repatriate FX proceeds after selling out of Egyptian government bonds. This negative watch is expected to be resolved – for worse or better – over the next three months. Expect pressure to remain on the Egyptian pound for another devaluation, with the risk of EGP implied yields spiking back to the 50%+ area.

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