FX Daily: Resistance (to dollar strength) is futile

The dollar continues to power ahead. Over the last 24 hours, the focus has switched from the pound to the Chinese renminbi. Here, there are signs that authorities are acquiescing to a weaker currency. With no sign that the Fed is going to ease its hawkishness nor the US administration showing any concern with the strong dollar, current trends should extend

USD: All systems are go

Whether it be US data surprising on the upside, the US administration showing no concern at all with the strong dollar, or new chapters in the energy war in Europe, it looks like all systems are go for the dollar rally. Trying to pick a dollar top in the current climate is an exercise in futility. The dollar is clearly in the midst of a very powerful rally and one akin to the macro settings in the early 1980s when US authorities were also trying to tame inflation.

What has caught our eye overnight is USD/CNH trading to a new all-time high above 7.20. The renminbi was seen as one of the more controlled currencies in the global economy, but after tweaks to FX required reserve ratios and stronger renminbi fixings failed to slow the move, it seems the Chinese authorities are as close to letting the renminbi float as they have been. The final roll of the dice might be to re-introduce the counter-cyclical factor in their daily fixings (allowing even stronger renminbi fixings) - but given that strong fixings have not worked so far, why bother?

The renminbi move could add another round of weakness to closely correlated emerging market and commodity currencies. We are thinking here of the big beasts in the EM space such as the South African rand and Brazilian real - and of course local Asian currencies, where the Singaporean dollar formally tracks the renminbi via its basket. And the pressure will continue to build on some of the more managed EM currencies such as the Egyptian pound and Nigerian naira, where implied yields through the 3m non-deliverable forwards are trading over 50% and 25%, respectively.

As far as Washington is concerned the strong dollar is someone else's problem - an advisor to President Biden said overnight that we were not headed towards another Plaza accord - the 1985 agreement to reverse dollar strength.

This all leaves the dollar in the ascendancy. DXY is close to 115 and in reality, there is not much resistance until 120. Favour shallow consolidations and further gains in this powerful stage of the rally. We doubt second-tier US data today, nor Fed speakers do much damage to the dollar.

Chris Turner

EUR: Deep-sea subterfuge

It is hard to know what to make of the presumed sabotage attack on Russian gas pipelines in the sea off Denmark. As Warren Patterson outlines in his Commodities Feed, those pipelines were not carrying any gas to Europe. Instead, the attack presents a pure geopolitical event - with investors awaiting how both the West and particularly the Russians respond.

The strong dollar environment and the deteriorating geopolitical situation in Europe have sent EUR/USD close to 0.9500. Traditional drivers of the EUR/USD such as two-year swap differentials and terms of trade are having no say in EUR/USD pricing right now. However, EUR/USD, at 0.9500, would be near the lower of a bearish channel that has contained this year's orderly descent in the dollar - so perhaps some consolidation may be due above 0.9500. But one-week EUR/USD implied volatility is still changing hands at the highs of the year 15% - warning of fast markets if 0.9500 breaks.

Chris Turner

GBP: No emergency BoE rate hike after all

Comments yesterday from Bank of England (BoE) Chief Economist Huw Pill were consistent with Monday's statement that the BoE would respond to the mayhem in UK asset markets at their regular monetary policy meeting on 3 November. This will have further disappointed the community looking for emergency rate hikes - we were not part of that community. Instead, the market seems to be settling on a view of a 'significant' BoE rate hike in the order of 150bp on 3 November.

We doubt BoE speakers today (Jon Cunliffe and Swati Dhingra) will have too much more to add. That leaves GBP/USD at the mercy of the strong dollar and a bias back towards 1.05 this week. Events on the continent may keep EUR/GBP constrained to an 0.8900-0.9000 range.

Chris Turner

CEE: Gas prices strike again

Yesterday's news about the sabotage of the Nord Stream pipelines and headlines that Gazprom sees the risk of sanctions on gas supplies via Ukraine have put gas prices back in the FX game. This triggered the first visible rise in gas prices in a week and tested the muted relationship with CEE FX. Unsurprisingly, this led to FX weakness across the region and this theme can be expected to drive the market for the rest of the week. The main news for us though is that the last pillar of strong FX in the region is gone for now and higher gas prices are adding to the side of falling interest rate differentials and a strong dollar. This is a net negative for CEE and we will see more weakness in the days ahead.

Meanwhile, in Hungary, the central bank surprisingly ended the hiking cycle with a higher-than-expected 125bp rate hike to 13.0% and plans to do the rest of the monetary tightening through liquidity measures. Earlier, the NBH introduced new measures to withdraw excess liquidity from the market in the form of higher reserve requirements for banks or the issuance of discount bills. The question is how successful the NBH will be with the new approach. However, the EU money issue remains on the table, and in conjunction with the gas story, we can expect further volatile weeks for the forint around the 405 EUR/HUF level depending on incoming news.

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