FX Daily: Resistance to dollar strength is futile

The dollar remains well-bid across the board as a relentless run of above-consensus US data suggests the Federal Reserve will be in no mood to relax its hawkish stance. Resistance to the strong dollar is crumbling - most notably in China where a higher USD/CNY fixing suggests the People's Bank of China is becoming more tolerant of renminbi weakness

Source: iStockphoto

USD: No reason to unwind dollar longs

The dollar is consolidating near the highest levels since March as US data continues to surprise on the upside. Following the above-expected ISM Services index on Wednesday, yesterday it was the turn of the weekly initial jobless claims to drop back to the lowest levels since February and question the narrative that tightness in the US labour market is easing. With activity data staying strong, it seems the market may be more minded to buy into the idea of another 'skip' - i.e. the Fed not hiking in September but hiking again later in the year. Clearly, this pushes the idea of a Fed easing cycle later and keeps the dollar stronger for longer.

As has been the case so often, the dollar is the United States currency and everyone else's problem. Here, both Japanese and Chinese officials are fighting against dollar strength - with limited degrees of success. Japanese officials are sounding like we could well see intervention shortly - e.g. in the 148-150 window in USD/JPY.

The highlight of the overnight session, however, has been the People's Bank of China (PBoC) allowing a higher fixing in the onshore USD/CNY. They have maintained the spread of the fixings to the model-implied fixings of around 1100 CNY pips, but the higher fixing has put paid to ideas that Chinese officials have some kind of line in the sand for USD/CNY at 7.35. USD/CNH is currently trading above that level. Low Chinese CPI next week and a PBoC rate decision with the one-year lending rate will keep expectations alive of further rate cuts too. The weaker CNY/CNH will continue to keep EM FX broadly offered and the dollar bid.

There is very little in the way of US speakers or US data today. The weekend sees a G20 meeting in New Delhi, with much focus on how new alliances develop following the recently announced expansion plans of the BRICS.

We cannot see investors wanting to offload dollar balances anytime soon. This suggests DXY stays bid near 105.00.

Chris Turner

EUR: Staying soft

EUR/USD remains fragile as US data stays strong and the news out of the eurozone and China remains bleak. We mentioned higher oil prices potentially weighing on the euro earlier this week and the focus today switches to natural gas, where it looks like LNG workers in Australia will go on strike after all. Higher natural gas prices will not be welcome news for Europe.

As for next week's European Central Bank meeting, the market now prices just 8p of rate hikes. And there is some focus too that the ECB might just lift the main refinancing rate (now 4.25%) while keeping the deposit rate unchanged at 3.75%. We doubt such a move would help the euro much.

Today should be a quiet session for EUR/USD. Yet there seems no reason for EUR/USD to bounce and pressure could build for sub 1.0700 levels if, for example, the international community drives USD/CNH to the 7.40 area.

Elsewhere, it looks like the Polish zloty will stay weak after a dovish press conference from the National Bank of Poland yesterday.

Chris Turner

GBP: Cracks appearing in the BoE tightening story

As our UK economist, James Smith, wrote yesterday, the Bank of England (BoE) received some welcome news in terms of price expectations from the corporate sector. This has added to the re-assessment of the BoE tightening cycle, where the policy rate peak (still priced for next February) is now at 5.60% versus the near 6.50% levels expected just a couple of months ago. This is why EUR/GBP is trading near 0.8570 and not near 0.84 on the back of the soft euro.

Expect EUR/GBP to continue to drift in this 0.85-0.86 range into next Tuesday's key release of the July compensation data - where the smart money may be looking for a downside surprise.

Chris Turner

CAD: Jobs prints are volatile, but BoC should be done anyway

Canadian jobs figures for the month of August will be released today. The headline employment number has been quite volatile, with the past four months having seen two very strong prints (April and June) and two sub-zero ones (May and July). However, the unemployment rate has ticked up in each of the past four months, from 5.0 in April to the current 5.5%. The consensus numbers are 17.5k and 5.6% for today.

Outside of the initial reaction for CAD, the implications of today's figures beyond the very near term should not be very significant, barring a very strong read. As discussed in our Bank of Canada meeting review note, we think rates have peaked in Canada, in particular following the dismal 2Q GDP reading (-0.2% quarterly, annualised).

USD/CAD is expensive, trading around 2.3% above its near-term fair value, according to our calculations, but any decisive turn lower remains tied to a turn in US activity data rather than domestic inputs on the Canadian side.

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