FX Daily: Shutdown and slowdown weigh on the dollar

The dollar has turned a little softer today after the US Congress failed to reach a deal to avoid a government shutdown. Investors are fearful that this could be a longer shutdown, which will only weigh further on consumer confidence and job security. We continue to favour some modest further gains for the yen and the euro

The US Capitol in Washington D.C

USD: The case builds against the dollar

As Francesco Pesole discussed yesterday, it has indeed been the more defensive yen which has benefited the most from the US government shutdown, which went into effect overnight. The moves in FX markets have been modest so far, but investors will be wary that this could be one of the longer shutdowns seen over the last 30 years. Shutdowns have typically lasted anywhere from three to 35 days. Presumably, Democrats are going into this shutdown eyes wide open, wanting to be known as the party that fought for healthcare when it comes to mid-term elections next November. And with Republicans controlling the congressional agenda and President Trump fully utilising his executive authority, the need for a 60-seat Senate approval for government funding is probably the only area in which the Democrats can flex their muscle.

Prior performance is no guarantee of future returns, but previous shutdowns have typically seen bullish steepening of the US yield curve, a slightly softer dollar and mixed news for equities. Currently, S&P futures are called 0.5% lower. What is probably more relevant for FX markets is the context of this shutdown. James Knightley put it nicely yesterday, when discussing the slowdown in US consumer confidence and the swing in sentiment towards jobs being harder to get. A government shutdown will feed into those trends – especially if President Trump follows through with threats to fire and not just furlough non-essential government staff. Remember that as many as 150k government staff lay-offs may hit the October non-farm payroll result as part of DOGE's austerity drive earlier this year. The shutdown also means we are unlikely to see weekly jobless claims on Thursday and the September payroll report on Friday.

For today, it still looks like we will receive the September ADP employment report and the ISM manufacturing report. Consensus on the former is around +50k, and the dollar could be vulnerable to a downside miss. The ISM index is still expected to be sub-50 today, and the prices paid component will be closely watched. However, our team's core view remains that tariff-related goods price inflation will be softer than initially feared and that the softening in the labour market and rental trends means that services inflation is heading lower. That should allow the Fed to cut in October and December.

DXY could drift towards the 97.20 area and USD/JPY to 147.00/147.20 – with softer US equities probably a dollar negative in the current environment.

Chris Turner

EUR: September CPI to keep ECB expectations anchored

A speech by ECB President Christine Lagarde was read as mildly dovish yesterday, in that the ECB being in a 'good place' did not prevent it from adjusting interest rates. As Carsten Brzeski discusses here, recent German activity data have come in on the soft side and the market has not completely ruled out one further ECB cut. With that in mind, we doubt the market will want to drive EUR/USD too much higher on what should be a rise in September eurozone inflation to 2.2% year-on-year today, while core is expected to remain at 2.3%.

However, we think the US government shutdown and the softer dollar story should dominate today and could be enough to drag EUR/USD to 1.1800/1820.

Chris Turner

CHF: Intervention, pharma and the franc

It's been quite a busy week for Swiss news. On Monday, the Swiss National Bank effectively increased the amount of CHF banking deposits exposed to a 0.25bp charge. The press release pitched that as a technical clean-up to last year's adjustment in minimum reserves. We would not describe this as a 'stealth' easing of monetary policy, but we will watch what happens to Swiss money market rates when the measure goes into effect on 1 November. It is a downside risk to the franc, however.

Late Monday also brought a very rare joint statement from Swiss and US authorities on the use of FX intervention. The SNB statement marketed this as a kind of blessing to use FX intervention as part of its regular monetary policy activities. Whereas the US version of the statement merely focused on the use of intervention to address disorderly or volatile markets. That may be the reason why EUR/CHF has not traded much higher on the news. And these releases preceded data which showed SNB FX buying intervention had picked up a little to CHF5bn in the second quarter.

We speculate whether the FX intervention statement has something to do with the pharma deals President Trump is announcing this week. Presumably, Washington wants to get the Swiss drugmakers onside as he launches his new 'TrumpRx' website to deliver drugs at discounted rates to US consumers. Pfizer was the first of the big companies to sign up to this yesterday. If this read is right, then, yes, maybe Switzerland does have Washington's blessing for continued FX intervention and can avoid being labelled a currency manipulator.

SNB FX intervention will be passive, however, and we forecast EUR/CHF to continue to trade near 0.92/93 into year-end.

Chris Turner

CEE: One step closer to rate cuts

Yesterday's inflation figures in Poland brought a small surprise, with September inflation unchanged at 2.9% YoY. However, food prices were the main reason for the slower growth. This leads our economists to believe that the National Bank of Poland will leave rates unchanged in October and wait for November and the new forecast. However, it took inflation that was one-tenth weaker than expected and below the 3% threshold as a signal that the National Bank of Poland has a clear path for a rate cut as early as next week's October meeting. Still, a rate cut in October does not necessarily mean further rate cuts in November or December, but the market remains on the dovish side of pricing.

Given that we are not far from pricing in two full rate cuts for this year, the market may see a hawkish surprise if anything. At the same time, EUR/PLN remains at the top of its current range of 4.240-275. Although conviction about the NBP's next steps is not high, we tend to believe that the PLN may see some rebound due to the Polish central bank and the grinding up of EUR/USD.

Today in the CEE region, we will see PMIs across the board, which could show some slight improvement in sentiment, with attention recently focused on the widening gap between the lowest levels in Poland and surprisingly good figures in the Czech Republic. Speaking of the Czech Republic, today we will see the September budget figures as well.

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