

FX Daily: The high-yielding Canadian dollar

The dollar is a little softer across the board as risk assets meet some bargain hunting. We are not looking for a significant top in the dollar yet, but for those that think the days of dollar strength are numbered, the Canadian dollar would make a good vehicle to express that view. The Bank of Canada should hike rates to 4% today, which should certainly help



The Bank of Canada in Ottawa

➔ USD: Corrective forces at work

The dollar has softened a little this week. The move looks less like any kind of de-rating of the US economy or the Fed cycle and more an issue of investors looking for bargains in bombed-out bond and equity markets. The MSCI world equity index is now nearly 10% off its lows – a move that has been helped by some stability in Europe (the end of Trussonomics) and probably the very high cash and underweight equity positions held by the investor community. It does feel like it is too early to declare the 'all-clear' for equity markets – e.g. the Fed could well push US real rates deeper into restrictive territory – meaning that we are treating this dollar decline as corrective.

After yesterday's soft US October consumer confidence data and [softer house prices](#), the focus

today is on new home sales, which may fall 15% month-on-month. It should be clear by now that the housing sector is firmly in the firing line of the Fed's restrictive policy, but it will be important to see other sectors of the US economy slowing for the Fed to conclude that aggregate demand is soft enough to offset supply constraints.

110 is a big psychological level for DXY and we would assume that it would hold ahead of another 75bp hike from the Fed next week.

Chris Turner

➔ EUR: Closing in on some big levels

It has been several weeks in the making, but it does now seem that EUR/USD is responding to the lower natural gas prices and the improvement in the terms of trade position. We should be a little careful here since EUR/USD is now threatening to break out of a bearish channel that has contained price action all year. That means a break of 1.00 could trigger quite a sharp short squeeze to 1.02 and at the very least slow the rate (5% per quarter) of this year's EUR/USD decline. It is probably a question then of whether the 1.00 level can hold EUR/USD up to and including tomorrow's ECB meeting, before next week's Fed meeting could provide some more support to the dollar.

Chris Turner

Today's Central and Eastern Europe (CEE) calendar is basically empty, but we will be monitoring the aftermath of yesterday's [meeting](#) of the National Bank of Hungary, which, as expected, produced no change in interest rates. However, the central bank made it clear that it is ready to act again if the situation calls for it. In the meantime, it will continue to withdraw liquidity from the market using the measures previously introduced to keep the forint under control. However, as we mentioned earlier, further upward jumps in EUR/HUF under global development pressure cannot be ruled out at this point, and therefore further monetary tightening by the NBH cannot be ruled out either. But for the time being, the forint and the whole CEE region should enjoy favourable conditions in the form of a further decline in gas prices and a return of EUR/USD to parity. On the other hand, the ECB meeting will come into play tomorrow, which may shuffle the cards in the whole region again.

Frantisek Taborsky

➔ GBP: Was that the bounce?

UK asset markets and the pound took another leg higher yesterday as new PM Rishi Sunak took charge. It is a familiar-looking cabinet with Jeremy Hunt welcomed by the markets as Chancellor. The UK's sovereign credit default swap has now recovered to pre 'fiscal event' levels, while gilt-bund spreads are now back near the 150bp levels seen in early September. The question is therefore whether sterling needs to rally much further.

1.1500 is clearly a big level in GBP/USD (as is 1.00 in EUR/USD). A break could see the correction extend to 1.1750. But such a correction would more likely be driven by a global re-assessment of risk (\$ negative) than a further re-rating of UK prospects. The UK data calendar is light today, with some focus on whether the 31 October medium-term fiscal plan will be delayed a few days. 0.8650-08750 looks to be the EUR/GBP near-term trading range.

Chris Turner

CAD: Canadian dollar deposits soon to start paying 4%

The Bank of Canada (BoC) meets to set policy rates today. As my colleagues James Knightley and Francesco Pesole [discuss in their preview](#), the BoC is expected to deliver a hawkish hike in the policy rate to 4.00% today. James thinks the BoC could hike a further 75bp in the cycle compared to the further 44bp currently priced into the Canadian OIS curve.

The Canadian dollar has been the best-performing G10 currency against the dollar this year, but is still down 7%. As above, if and when the dollar turns, the Canadian dollar should be at the forefront of the move. The problem has been, however, that the Canadian dollar has the highest correlation of the G10 currencies with world equity markets – in a bear market for equities.

In the Canadian dollar's favour, however, will now be 4% deposit rates. Interestingly an [IMF paper released earlier this year](#) on the 'Stealth erosion of dollar dominance' concluded that three-quarters of central bank FX reserve diversification away from the dollar over the last 20 years had gone into nontraditional reserve currencies such as the Canadian dollar. Presumably, interest in the 4%-yielding AAA Canadian dollar securities will only build from the reserve management community. It helps as well that as an energy exporter, Canada has been on the right side of this year's terms of trade shock. Certainly, we look for a move back to and probably below 1.30 in USD/CAD next year.

Timing is everything, of course. If equity markets can remain stable today, the hawkish BoC event risk could push USD/CAD down to 1.3500 on the day. But a sustained move below there requires a turn in the big dollar trend, which may not be a story until 2Q23.

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