

FX Daily: The Saudi squeeze brings energy back into the FX mix

If the beleaguered euro and yen did not have enough to worry about already, they now have to cope with Brent oil trading above \$90/bl as the Saudis extend their supply cuts through to year-end. Unless the US ISM services index somehow collapses today, expect the dollar to remain in demand. EUR/JPY, however, could start to turn lower based on positioning



📈 USD: ISM services the only threat to an otherwise bullish story

The relentless rise of the dollar continues. The DXY yesterday pushed up to the highest levels since March as US yields once again edged higher. While the busiest day in US investment-grade corporate issuance in three years has surely been weighing on US treasuries, the FX market has also come under the spell of higher energy prices. The [Saudis have this week confirmed](#) their plan to roll over their 1mn barrels per day supply cut into December. This is keeping conditions tight in crude energy markets and now sees Brent trading over \$90/bl. To FX markets, that provides an unwelcome reminder of the spike in energy prices last summer which had hit the energy-importing currencies in Europe and Asia.

US energy independence and its net exporter status leave the dollar well-positioned for higher energy prices. It would seem the only real threat to the dollar in the near term would be some dramatic re-assessment of growth prospects. That brings us to the key piece of US data this week – today's release of the ISM services index for August. A sharp fall in this series did weigh on the dollar at the tail end of last year, but unless this really surprises with a sub-50 reading today, expect the dollar to hold onto recent gains and consolidate at these high levels before the US August CPI release this time next week.

In terms of G3 currencies, we might see some re-adjustment, however. Speculators still seem to be holding onto long euro positions, while they continue to run very short positions against the yen on the carry trade. USD/JPY upside now looks more limited as rhetoric from Tokyo threatens imminent intervention. Positioning suggests EUR/USD support levels are more vulnerable. EUR/JPY may now struggle to get over the 158.50 area and may be about to embark on a correction to the 155 area.

Chris Turner

⬇️ EUR: EUR/USD looks vulnerable

We are increasingly hearing the term 'stagflation' to describe the Eurozone economy. As a growth-sensitive currency, stagflation is bearish news for the euro and was one of the key factors weighing on it at its birth in 1999. Adding to that story is now the supply-driven spike in energy, reviving fears of last summer's negative terms of trade story for the euro. In practice, that meant the eurozone's traditional trade surpluses turned into deficits and the euro got hammered. With natural gas prices still very subdued, this energy story will not hit the euro as hard as last year, but it remains unwelcome.

Regarding European Central Bank (ECB) policy, the market prices just a 25% probability of a 25bp hike next week. We think the chances are much higher than that. However, speculative positioning and the energy story leave EUR/USD in a vulnerable position and EUR/USD could easily slip through support at the 1.0700 area in a move to the 1.0635/40 area.

Elsewhere in Europe today, we should see the [start of an easing cycle in Poland](#). The move looks well-telegraphed and perhaps should not weigh too much on the zloty. However, the softer EUR/USD story and higher oil prices look to keep the zloty on the back foot near term.

Chris Turner

➡️ GBP: Look out for BoE Governor Andrew Bailey at 3:15 pm CET

Sterling is coming under pressure against the strong dollar and marginally outperforming the pressured euro. High wage growth looks to be the primary reason for the market retaining expectations of a further 57bp of Bank of England (BoE) tightening in this cycle – making pivotal next Wednesday's release of the average earnings figures for July. Our base case is one more 25bp hike from the Bank on 21 September and then a prolonged pause.

The manufacturing slump in the eurozone and these high energy prices suggest EUR/GBP can trade at the lower end of that 0.8500-0.8600 range into that BoE rate meeting on 21 September. GBP/USD looks more vulnerable to a firm test of 1.2500 psychological support.

Chris Turner

➔ CAD: An unsurprising pause by the Bank of Canada today

USD/CAD printed the highest level since March yesterday, briefly breaking above the 1.3660 April high following another round of USD strengthening and generalised softness in pro-cyclical currencies. We don't expect today's Bank of Canada meeting to be a turning point for the loonie, as policymakers should take into account the recent weakness in growth and the cooling labour market and opt for a pause – [here is our full preview](#).

The dovish move in market expectations has already happened and markets are expecting no change today, while a modest 9bp is left in the CAD OIS curve before year-end. This means that the downside risks for CAD from today's pause should be limited, also because the BoC will likely want to avoid categorically closing the door to more tightening just yet.

The rise in USD/CAD in the past month has not been mirrored by a divergence in the USD/CAD short-term divergence of similar magnitude, and the pair is currently 2.5% overvalued according to our short-term fair value model. While a turn in US activity data likely remains necessary to pull the trigger on a USD correction and close the mis-valuation gap, we think that further USD/CAD gains will prove increasingly unsustainable. A retracement to the 1.3460 200-day MA is our preferred bias for September.

Francesco Pesole

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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