

FX Daily: Tide turning against the dollar

The dollar remains close to the lows of the year. Equity markets are reacting in a way that expects the Federal Reserve to deliver a soft landing, and the recent steepening of the US yield curve at this stage in the cycle is normally associated with a weaker dollar. The big question for markets is whether we are going to see a range breakout



📉 USD: Softer amid intra-day volatility

Amid much intra-day volatility, DXY is down around 0.5% on the week. That's not much, but DXY is now just a whisker away from the lowest levels in two years. The story here is fading US exceptionalism as acknowledged by the Fed in this week's [pre-emptive 50bp rate cut](#). So far, equity markets like what they see and interest rate-sensitive growth stocks have performed well. It seems obvious now that US labour market data will be the key macro driver of the dollar story into year-end. That's why the dollar saw a decent intra-day bounce yesterday on the lower-than-expected weekly initial jobless claims data.

The dollar is also moving in line with the US yield curve, where the expected steepening at the start of a Fed easing cycle is normally a weaker period for the dollar. Equally, seasonal factors tend to turn against the dollar from October onwards and we would add that the external position for the dollar is starting to look a little weaker. US second quarter 2024 current account data released yesterday saw the deficit widen to a reasonable 3.7% of GDP. On the financial flows side, the

majority of flows into the US were in the long-term debt category. We wrote [on the subject earlier this year](#) that heavy inflows into long-term debt could cause a problem for the dollar should the lack of any fiscal consolidation undermine the US Treasury market over coming years.

But the big question for the market right now is whether the dollar is ready to break out of its two-year range. We think it may well do because of some of the factors outlined above, but the timing remains uncertain. One never knows whether investment committees of buy-side firms decide to raise their FX hedge ratios on US investments and put dollar sell orders through at the WMR fix at 4pm London time.

There seems nothing on the agenda today to justify a breakout, but suffice to say we are in the camp looking for some strong follow-through selling should DXY support levels at 99.50/100 give way.

Also, look out for the Bank of Japan press conference. We do not fully understand the reference in today's BoJ statement that FX markets can affect prices more than before because domestic wages are growing. Perhaps Governor Ueda will explain more in the press conference. In general, however, we remain bearish on USD/JPY and favour a move to 138 over the coming weeks.

Chris Turner

📈 EUR: Don't want to miss the breakout

Having bounced around on yesterday's US initial claims data, EUR/USD is back near the recent highs at 1.1180. This looks to be a function of a broad move in the dollar. We have mentioned this before, but EUR/USD looks to be on the verge of breaking out of a low volatility range. For example, a weekly close above 1.1160 - the upper twenty-month Bollinger Band - warns of a sizable upside breakout. At this stage in the US cycle, we believe an upside EUR/USD breakout is entirely possible.

There seem no immediate catalysts for that upside breakout today given the lack of US data and only second-tier eurozone releases. Let's look out for a speech from Christine Lagarde at 17CET today. The market still has 6bp of an October ECB cut priced - which should come out of the market at some point. A 1.1150-1.1200 EUR/USD range may well be seen today, though we retain an upside bias.

Elsewhere, EUR/CHF is moving higher. A better risk environment may be helping - but so too is USD/CHF. Here, USD/CHF seems to spike higher every time it trades below 0.8400. Whether that is a commercial or Swiss National Bank flow is hard to say. We would not chase EUR/CHF higher, however, since the SNB may not deliver on all of the dovishness priced into next week's policy meeting.

Chris Turner

➡ GBP: Hard to argue with sterling strength near term

Sterling's rally on yesterday's Bank of England communication looks fully justified. UK short-dated yields rose relative to their eurozone counterparts as the BoE stuck to the new script of 'gradual' easing. The BoE does genuinely seem to be questioning whether inflation will come down as much as elsewhere in the world and continues to present three scenarios. The BoE certainly does not

seem to be in the Fed camp of signalling the 'all-clear' on inflation. Our UK economist, James Smith, does expect the [BoE to come round to the Fed's way of thinking](#). That may take some time, however, and in the meantime, sterling can continue to do well.

Thus it's hard to rule out GBP/USD making a push to the 1.35 area, while EUR/GBP could extend to 0.8340. August UK retail sales have helped sterling today, but leading indicators for consumer confidence warn that consumers are starting to become fearful of the 30 October UK budget.

Chris Turner

CEE: Market gaining before central bank meetings next week

The last day of the week should be quiet with an empty calendar in the CEE region. However, the FX market has a lot to absorb. Overall, we remain bullish on the CEE region, just like at the start of the week. The most attractive at the moment seems to be Hungary's forint, which in the rates market repriced up significantly for no visible reason, while EUR rates fell slightly. Thus, at the end of the day, the interest rate differential moved to the highest level in weeks, adding support to FX. Moreover, EUR/USD is still testing higher levels favouring CEE currencies in general. Thus, we think EUR/HUF should move into the 392-393 range by Tuesday's National Bank of Hungary meeting, supporting a 25bp rate cut, which is our economist's call. On the other hand, Tuesday's meeting should be a reason for a reversal and our medium-term view is more negative on HUF, with the upper side of our trading range for the rest of the year at 392-400.

Another currency preparing for next week's central bank meeting is the Czech koruna, which has been enjoying stronger values in recent days and is slowly approaching 25.00 per euro. As we mentioned earlier, the market pricing is still on the very dovish side, but given the core story, it makes no sense to go against the received market. On the other hand, still, the Czech National Bank meeting should be reasonably hawkish and CZK should benefit the most from it. Therefore, we still find the CZK attractive for the days ahead, when we should test 25.00 EUR/CZK.

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