

FX Daily: Treasury slide keeps markets nervous

This week's highlights include the Fed's Jackson Hole symposium, the 15th BRICS summit and flash PMIs for August. The steady slide in US Treasuries presents a headwind for risk assets and should keep the dollar in demand



USD: Treasury slide supports the dollar

It has been a quiet start to the week for FX markets. Chinese authorities have delivered another rate cut – but this time the one-year loan prime rate has been lowered 10bp to 3.45%, while the 5-year loan prime rate has been unexpectedly left unchanged. The latter rate is seen as more important to Chinese mortgage markets and raises questions about how China plans to stimulate demand in that sector. The rate cut did not see large moves in the renminbi, and the ongoing low USD/CNY fixings suggest Chinese authorities are trying to draw some kind of line in the sand near 7.35. Unlike the Japanese, who are very transparent with their FX intervention activities, it is hard to discern whether Chinese authorities are intervening to sell dollars near current levels. However, with China employing monetary stimulus, expect the renminbi to stay soft and remain a popular funding currency.

The dollar looks set to hold onto its gains this week. In focus will be Friday's speech from Fed Chair

Jay Powell at the Jackson Hole symposium. This comes at a time when US 10-year yields are closing in on 4.30%, and our [rates strategy team favours 4.50%](#). Intriguingly, the team notes that the US 10-year yield correlates most with the pricing of the policy rate four or five years forward. In other words, the Treasury sell-off is less about the terminal rate for this tightening cycle and more about where the Fed Funds rate settles under more normal conditions. Chair Powell could shed some light on this on Friday. The bottom line, however, is that it looks too early for the Fed to sound the all-clear on inflation and the dollar probably holds its gains.

DXY is holding gains above the 100-day moving average at 103.20 and can probably edge up to 104.00 this week.

Additionally this week, look out for headlines from the BRICS summit (taking place August 22-24) in South Africa. The topic of BRICS expansion tops the agenda and inevitably will raise questions over the threat of de-dollarisation. Any evidence of that is very scant so far, as we note in our full report [here](#).

Chris Turner

➔ EUR: Another batch of soft PMIs?

Before ECB President Christine Lagarde's speech on Friday, the highlight in the eurozone this week will be Wednesday's release of flash PMIs for August. Currently, gloom is descending on the European outlook, including the re-introduction of Germany's description as the 'sick man of Europe'. Let's see whether the manufacturing PMIs deteriorate any further and also whether services PMIs cross decidedly into sub-50 territory.

EUR/USD is starting to look quite comfortable below 1.09 and below support at 1.0835/45 could make a dip down to the 1.0775 area. Certainly, with US Treasury yields pushing ahead and proving a threat to risk assets – and China still fragile – EUR/USD will struggle to make it back above the 100-day moving average at 1.0930.

Chris Turner

➔ GBP: Holding onto gains, short term

The Bank of England's trade-weighted sterling index continues to trade near the highs of the year, no doubt propped up by high short-term interest rates. 3m GBP implied yields of 5.40% make it very expensive to FX hedge positions on UK bond markets, for example.

It may well be that this sterling strength endures to the next set of releases on UK wages and CPI (September 12th and 20th respectively), with more mileage to be had against the euro than the dollar given headwinds to the external investment environment.

For this week, the UK calendar is light until Wednesday's release of PMI data. EUR/GBP can stay offered in a 0.8500-0.8550 range, while GBP/USD remains trapped well inside last week's narrow range of 1.2615-1.2785.

Chris Turner

📈 CEE: Rates matter again

This week, we will see a number of hard data from the Polish economy. Industrial production, PPI and wage numbers will be released today. Our economists expect another 0.5% year-on-year decline in industrial production – better than market expectations. However, the slowdown in China and the weak performance of German industry shows the risk of another weak result for Polish industry. On the other hand, wage growth should confirm steady double-digit growth. Tomorrow, Poland will remain the main focus with the release of retail sales and construction data. Thursday will see consumer confidence data in the Czech Republic, which could show further improvement thanks to a rapid slowdown in inflation.

On the sovereign rating side, Fitch will publish a review of the Czech Republic on Friday. The agency downgraded the outlook to negative from AA- stable in May last year, mainly due to the deteriorating fiscal policy trajectory. However, the negative scenario has not materialised since then, and the government has unveiled a large consolidation package resulting in a rough halving of the public deficit next year. We therefore expect the outlook to return to stable.

In the FX market, CEE currencies have gained some ground in the past week after some time despite the fact that US dollar levels are not making the region's life easier. In our view, the gains were mainly driven by rising market interest rates and support from the interest rate differential. Moreover, after weeks of weakness, more balanced positioning across the region is also helpful. Interest rates drivers seem to be back after a long time, and Friday's move indicates further gains for today. The Polish zloty seems most tempting from this perspective, almost touching 4.50 EUR/PLN last week, which we believe is the upper ceiling of the current 4.40-4.50 range. Unless today's data surprises on the negative side, we could see further gains below 4.44 EUR/PLN. The Czech koruna should finally settle below 24.00 EUR/CZK.

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