

## FX Daily: US bond market sets the FX tone

The ongoing sell-off in the US bond market continues to set the tone – not just for FX markets but for risk assets in general. A heavy slate of US Treasury auctions this week and rising concern over a US government shutdown on Saturday is sending implied volatility higher and may trigger some more profit-taking on carry trade strategies



The biggest market talking point is the ongoing bearish steepening of the US Treasury curve

### USD: Focus on Treasuries again

The dollar continues its grind higher and probably the biggest market talking point is the ongoing bearish steepening of the US Treasury curve. Speaking to our bond strategists, they think this is currently being driven by two factors. The first is the ongoing upward revision to where the Fed Funds rate settles after the next Fed easing cycle. Looking at the forward curve for one-month USD OIS rates, investors now see the low point in any future Fed easing cycle at around 4.00% in three years' time. Rather incredibly, at the start of this year, the market had seen the low point for Fed Funds in three years' time down at 2.70%.

The second factor weighing on Treasuries is this week's \$134bn auction of two, five and seven-year notes – which takes place over the next three days. This comes ahead of a potential US government shutdown this Saturday, where hard-right Republicans in the House seem to be holding out against a stop-gap spending bill. In the background remains a threat of another downgrade of US sovereign rates on the back of an 'erosion of governance'.

Apart from the rise in US yields, we have now started to see a rise in implied volatility in the US Treasury market. This will prove a headwind to carry trade strategies and could prompt the unwinding of some of the most heavily invested positions. We would worry about the Mexican peso here, which also faces [Banxico unwinding its dollar forward book](#) in less than benign conditions. Another popular target currency in the carry trade – the Hungarian forint – may actually find some support from the local central bank today (see below).

In general, however, the continued rise in US yields is making for a less benign environment and favours risk reduction. Whilst higher US yields may push USD/JPY close to 150, they also increase the risk of an equity setback. That is why we think an instrument like the one-month USD/JPY downside risk reversal may be too conservatively priced. And in general, we would say commodity currencies remain vulnerable, especially those like the South African rand and Latam currencies – this latter group were hit hard during the early August sell-off in Treasuries.

DXY can probably stay bid through this if activity currencies come under pressure and technical analysts will be dusting off calls for a move to the 107.20 area.

*Chris Turner*

## 📉 EUR: Falling world trade does not help

Not helping the euro has been data released showing that world merchandise trade volumes fell another 0.6% month-on-month in July. As a relatively open economy, the eurozone suffers from a declining trade environment, as does the euro. Our banking analysts have also written that the [ECB is considering raising the Minimum Reserve Requirement](#) for the banks that it supervises. This would tighten conditions still further and add more growth pessimism in the euro area. The Eurostoxx 50 index is now down nearly 8% from its highs at the start of August.

EUR/USD remains soft having broken below support at 1.0600/0610. Without support from extreme under-valuation or existing heavy short positioning, EUR/USD looks as though it could sink into the 1.0480/1.0510 support area.

Elsewhere, the Swedish krona is performing surprisingly well given this high interest rate environment. Unlike the euro, the krona is backed by extreme fundamental under-valuation. Additionally, news that the troubled Swedish property developer, SBB, has secured liquidity by selling some of its property portfolio alleviates some fears of a funding crisis. And the market will no doubt be speculating that the Riksbank has started hedging its FX reserve portfolio, [as promised last week](#). While tough external conditions hardly make it the occasion to chase EUR/SEK lower, the factors above could mean NOK/SEK drops back to the 1.01 area.

*Chris Turner*

## ➡ GBP: An expensive sell

With one-month implied yields at 5.20%, sterling is an expensive sell. For that reason, we think EUR/GBP may continue to trade in the 0.86-0.87 range for the time being rather than continue to march higher. GBP/USD is a different story where the ongoing strength of the dollar and the softening risk environment warn that little support can be expected before the 1.2000/2075 area.

UK-specific inputs are light at the moment. But because last week's [Bank of England vote for unchanged policy was so close](#), the market is reluctant to completely price out the risk of one last

rate hike.

*Chris Turner*

## HUF: NBH to stress caution for the rest of the year

There is only one event on the agenda in the CEE region today and that is the [meeting of the National Bank of Hungary](#). Today's meeting seems like a done deal – the effective interest rate and the key interest rate will be merged at 13%, and monetary policy will thus enter the second phase of normalisation.

The question is what to expect in October and how much today's press conference will indicate. In any case, a cautious and hawkish tone can be expected. This goes against the dovish market expectations, which have priced in rate cuts in the 75-100bp range at the following meetings and high EUR/HUF levels at 390. Thus, the hawkish tone should be an impetus for the market to reassess expectations, especially at the short end of the curve, and support the forint back to levels safely below 390 EUR/HUF.

*Frantisek Taborsky*

### Authors

#### **Chris Turner**

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

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### **Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

#### **Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by

the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.