FX Daily: US Treasury wobble unnerves risk assets

A sell-off at the long end of the US Treasury market has cast a shadow over risk assets and hit cyclical currencies. The dollar has been the main beneficiary. Expect focus to very much remain on the US bond market into next week's quarterly refunding. For today, attention is on whether the BoE hikes 25bp or 50bp and how Brazilian assets react to the 50bp rate cut

USD: Tracking Treasuries

Wednesday's session was all about the US bond market and the sell-off at the long end of the curve. US 30-year Treasury yields were briefly 15bp higher. And far from the benign bullish disinversion of the curve we saw after the soft June CPI print, yesterday's move was a more negative bearish steepening. Higher risk-free rates hit US growth stocks (Nasdaq -2%) and also hit 'growth' currencies, such as the commodity complex and the unloved Scandi currencies.

At the heart of yesterday's move was the US fiscal story. Despite the Democrat administration and its supporters in the media decrying Fitch's decision to remove the sovereign's AAA status on Tuesday evening, there is genuine concern over US fiscal dynamics. And it looks like the Fitch release was carefully timed. Yesterday also saw a slightly higher than expected US quarterly refunding announcement, where $103bn of 3, 10, and 30-year bonds will be sold next week. The fact that fiscal dynamics were in play yesterday was reflected in wider US asset swap spreads (Treasuries underperforming the US swap curve) and the US yield curve steepening.

As above, higher risk-free rates are providing greater headwinds to risk asset markets - including equities. We are also seeing some slightly higher cross-market volatility readings which may prompt investors to partially de-risk from carry trade strategies (good for the Japanese yen and Swiss franc on the crosses, bad for the high yielders). We will also be interested to see how the Brazilian real performs today after Brazil's central bank started its easing cycle last night with a 50bp cut and promised similar magnitude cuts over coming meetings. The currency could edge a little lower today given the international environment.

While the US Treasury story will be with us into next week's auctions, the focus today will be on the initial jobless claims (these have been moving markets) and the services ISM index. Barring a significant rise in claims or a big dip in the services ISM, it looks like the dollar will hang onto recent gains into what should be a decent US July nonfarm payrolls report tomorrow.

DXY could grind its way toward the 103.50 area.

Chris Turner

EUR: An episodic correction

EUR/USD is currently going through its third significant correction of the year. The corrections in February and May were worth 5% and 4%, respectively. The current correction is around 3%. These corrections largely come on the back of heavy one-way positioning, given that most expect EUR/USD to be higher by year-end - the current consensus is for 1.12. We would warn against getting too pessimistic on EUR/USD because of the European Central Bank. True, the market has taken 15bp out of the expected ECB tightening cycle over recent weeks, but as our colleague Peter Vanden Houte outlined yesterday, core inflation is still high and the September ECB meeting should still be considered 'live' for a 25bp rate hike.

For today, the eurozone calendar is light and EUR/USD will again be driven by US inputs. Unless US activity data surprisingly softens today, expect EUR/USD to continue to press the 100-day moving average near 1.0930, below which there is an outside risk to the 1.0850 area. We do, however, believe this dip should be temporary and continue to forecast 1.12 by the end of September on further signs of US disinflation and finally some softer US activity data, too.

Elsewhere we see Swiss July CPI data today. The headline rate is expected to fall further to 1.7% year-on-year and the core to remain at 1.8%. Despite this, the Swiss National Bank (SNB) is expected to remain hawkish and hike 25bp at its September meeting. The SNB also continues to guide the nominal Swiss franc higher. Given that USD/CHF is now rallying, the SNB may need more of that trade-weighted Swiss franc appreciation to come via EUR/CHF. That could mean that 0.9650 now proves the top of a new - and lower - 0.9500-0.9650 range.

Chris Turner

GBP: Some downside risks to sterling

The Bank of England announces its interest rate decision and releases a new Monetary Policy Report (MPR) at 1300CET today. Most analysts expect a 25bp hike in the Bank Rate to 5.25%, but a significant minority are looking for a 50bp rate hike. Money markets price around 32bp of tightening today.

Despite the welcome UK June CPI figures, no one expects the BoE to let its guard down on inflation and its statement will likely retain words to the effect that rates could be raised further were there evidence of more persistent price pressures in the economy. The market will also be looking out for the CPI forecasts in the monetary policy report and also whether the BoE has anything to say about Quantitative Tightening (QT), currently running at a pace of £80bn per annum. Some are arguing that QT could be accelerated to well over £100bn p.a.

A slightly risk-off environment and our baseline call of the BoE only hiking 25bp could be a mild negative for sterling – especially were the BoE to go further than the Fed in acknowledging the process of disinflation. For cable that means an outside risk of a drop to the 1.2580/2600 area (depending on the dollar environment), while EUR/GBP could be correcting back to the 0.8640 area.

Chris Turner

CZK: The CNB's last chance to send a hawkish signal

There is only one event on the calendar today in the CEE region and that is the meeting of the Czech National Bank. A rate change is not on the table this time either, in our view. However, we think it should be one of the most interesting sessions this year. Firstly, rapid disinflation opens up the question of a first rate cut; secondly, the weak koruna in turn raises the question of FX intervention and the postponement of rate cuts; and thirdly, the CNB will release a new forecast which may be the central bank's last attempt to reverse very dovish market expectations.

The Czech koruna has erased some losses in recent days but it seems to have been more related to the rebalancing of bonds within the GBI-EM index than due to any CNB hawkishness. So yesterday the koruna closed slightly below 24.0 per euro, which we believe is the pain threshold for the central bank. We believe that the CNB will try to support FX somehow given that it has become the pillar of monetary policy over recent months. The market is not buying into CNB hawkishness very much and so today's unveiling of the new forecast is likely to be the last chance to fight the market's dovish expectations. Financial markets are pricing in roughly 115bps of rate cuts this year, while we see 50bps in total in two steps in November and December. We think the CNB will try to paint a similar picture, which should support the koruna closer to 23.80 EUR/CZK.

Frantisek Taborsky

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com