FX Daily: What to make of USD/CHF at parity?

The highest core US inflation since 1982 has seen expectations of the terminal Fed rate push close to 4.90%. Despite the wild and ultimately positive gyrations in asset markets yesterday, the core narrative will remain one of the Fed continuing to push real rates and the dollar higher. A strong US September retail sales figure today should support the $

USD: Highest core inflation in 40 years

As James Knightley noted [in his review of the September US CPI release](), core inflation has not been this high since 1982. This suggests there will be no letup in the Fed's hawkish rhetoric and, consequently, markets are still searching for the terminal rate of this Fed hiking cycle. Those trying to pick a top in the cycle are continuing to be swept away. From pricing the Fed terminal rate at 4.45% barely two weeks ago, 23 March Fed fund futures now price the top near 4.90%.

The poor inflation print saw some immediate bearish flattening of the US 2-10 year Treasury curve

(US two-year Treasury yields are now 4.45% having started the year at 0.75%) and a broadly stronger dollar – yet the dollar rally quickly reversed as equities turned sharply higher. Presumably, positioning had something to do with this, where buy-side surveys show investors have: a) the most underweight equities ever and b) the most overweight cash (6%) since October 2001. More than $260bn has left equity mutual funds this year and we can only guess that some investors used the CPI event risk as an opportunity to feed money back into equities.

Yet the core narrative remains that the Fed will want higher real rates for longer to fight the biggest inflation threat since the early 1980s, and the dollar should continue to find good support on dips. 111.50/112.00 may be enough of a correction for DXY and some decent US data later today may be enough to give the dollar a lift. We have September US retail sales and consumer confidence. James Knightley thinks that retail sales could come in on the strong side given good car sales data and lower gasoline prices. It was also interesting to see JP Morgan chief executive Jamie Dimon say that he felt that US consumer spending could hold up for nine more months, given high savings and low debt levels – sentiments echoed in the recent FOMC minutes. On the subject of US banks, today sees third-quarter earnings releases from JPM, Citi, Wells Fargo and Morgan Stanley. We're no equity strategists, but it seems hard to expect a sustainable equity rally from here given what the Fed is planning to do with real rates.

Chris Turner

EUR: Led by sterling

EUR/USD is currently being dragged around by UK asset markets and the pound. Reports yesterday that ECB staffers felt that the ECB terminal rate could be somewhere near 2.25% versus the nearly 3% priced by the market had little effect on EUR/USD. Instead, EUR/USD sits comfortably in a bearish channel that has guided it lower all year – running at roughly -5% per quarter! The top of that channel is now around parity and should be the extent of any unforeseen short squeeze here. There is not much eurozone data today but an expected August trade deficit of €45bn is a far cry from the €20bn+ surpluses run in early 2021 and is a reminder that the euro no longer has the backing of a large current account surplus. 0.9850/70 may be the extent of any intra-day EUR/USD correction.

Chris Turner

GBP: BoE holds government toes to the fire

One cannot help but think the Bank of England (BoE) has played the poor hand it has been given quite well in potentially forcing the government into a U-turn on fiscal policy. There is no confirmation of such a policy shift yet, but no doubt Twitter will nearly break today on speculation of a shift in policy or personnel. Central bank independence is hard won and the BoE has clearly not wanted to succumb to accusations of government financing. GBP/USD continues to trade on a super-high one-week realised volatility near 20%.

We suspect that GBP/USD may struggle to break the 1.15 area. Will it trade back to 1.20, where it was before fears of a Liz Truss government started to hit the Gilt market? Probably not. Equally, EUR/GBP was trading at 0.84 in early August and we would say the political risk premium and a difficult external investment environment will make it hard for EUR/GBP to sustain a move under 0.8550/8600.

Chris Turner

CHF: What to make of USD/CHF at parity?

Apart from (reasonably successful) currency floors in EUR/CHF and EUR/CZK over recent years, it is hard to think of any successful 'lines in the sand' in global FX markets. Global capital and trade flows are simply too large for central banks to defend one particular level – as we see with USD/JPY now grinding to 147.50, well above the Bank of Japan's 145.70 intervention level in late September.

But what about the 1.00 level in USD/CHF? Yesterday was the third time this year that it reversed sharply from levels just above 1.00. Could the Swiss National Bank (SNB) be at work here? Recall that the dollar is the second-largest weight in the Swiss franc trade-weighted basket and a higher USD/CHF will naturally weaken the nominal trade-weighted Swiss franc – something the SNB wants to avoid as it battles inflation. In fact, SNB president Thomas Jordan is turning into one of the most ardent hawks in the central bank community.

We have quite a forthright view on EUR/CHF at the moment that the SNB wants to guide it lower by 5% plus per year. The higher USD/CHF is making the trade-weighted Swiss franc even softer and if we are right in our analysis, the SNB should be even more inclined to drive EUR/CHF down to 0.95 and away from the near 0.98 levels at which spot EUR/CHF trades today.

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