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FX

Rotation to debt doesn't hurt the dollar

The recent flattening of the US yield curve hasn't hurt the dollar



Source: iStock

↑ USD: Looking stronger

It's probably too early to talk of a great rotation from US equities into debt, but the recent 10bp flattening in the US Treasury curve hasn't really hurt the dollar. That's probably because dollar hedging costs are too expensive even were international fund managers to switch into debt. This view has been supported by recent surveys of Japanese Life Insurers expressing an interest in increasing their purchases of unhedged foreign debt were USD/JPY to correct under 110. At the same time, geopolitical challenges make it difficult to invest in either China/Asia or Europe right now and that suggests investors will continue to prefer running US risk. A strong 3Q18 US GDP figure this Friday and talk of another Trump tax cut only supports this strategy. DXY could push above 96.15.

↓ EUR: Italian fatigue?

Even though EUR/USD is not moving that much, vulnerability remains. We can't see any relief rally coming ahead of the S&P rating decision on Italy this Friday evening and indeed 1.1430 EUR/USD support could yield at any time. We still feel that EUR/USD could break as low as

1.1320 this week, and you can read more about that argument [here](#).

↓ **SEK: Riksbank confirming key forward guidance message to have little impact**

We don't look for any change from the Riksbank at today's meeting, neither in the level of interest rates nor in the forward guidance), with the central bank reiterating its intention to hike rates in either December or February. We believe the improvement in core inflation in September could shift the balance of risks in favour of a December hike. But any positive effect on SEK from the expected rate hike should be offset by the usual year-end seasonal krona decline. On the flip side, a dovish Riksbank message could see EUR/SEK run above 10.40 today.

→ **CAD: Will need an ultra-hawkish BoC message to drive the currency higher**

The Bank of Canada will meet today and the central bank is set to continue its gradual tightening path by raising rates by 25bp. This should be no surprise as headline inflation has been out of the BoC's comfort zone for some time now – hitting the upper threshold of 3% YoY in July. Market expectations have slightly cooled in recent weeks (although it looks to be fully priced in now) and we think a follow-through of a hike should give CAD a knee-jerk boost. But with a 100bp of tightening already priced in over a 2-year horizon, we see limited scope for a sustained rally in CAD – unless the BoC send an ultra-hawkish signal today. This seems highly unlikely, so look for USD/CAD to swiftly regain 1.30 post-meeting.

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