USD: Markets scale down Fed cut expectations

US economic data has led to a sizable repricing in the market's expectations for Fed rate cuts

Source: iStock

USD: Oil jumps, Fed cut expectations fall

Markets are set for a tumultuous start to the week after drone attacks on Saudi Aramco oil production facilities in Saudi Arabia resulted in the country's crude output being halved. Despite the company pledging to restore production starting from today, oil prices have surged by almost 20% in early trading. This situation has prompted an unusual scenario in the FX market, with risk-sensitive oil currencies (Norwegian krone, Canadian dollar) rising in tandem with safe heavens (Japanese yen, Swiss franc), with the latter two being pushed higher by concerns of rising geopolitical risk (US Secretary of State Pompeo blamed Iran for the attacks). As highlighted by our commodities team, it is unclear how long the disruption will last, but other production sources will be able to meet demand for just a few days. Should it have a more long-lasting impact on oil output, oil may be set for another upside shock. Elsewhere, the FOMC policy announcement on Wednesday will dominate the scene in the US this week. Last week's data flow (higher core inflation, stronger retail sales) seems to suggest that we may see a reiteration of the "mid-cycle adjustment" rhetoric. This has partly been mirrored in a sizable repricing in market rate cut expectations. Only two weeks ago, the OIS curve was showing nearly five quarter-point cuts priced in by the end of 2020, as of today, only 85bp of cuts are shown in the curve. Meanwhile, an empty calendar to start the week should keep the dollar mostly driven by external factors (i.e. trade tensions and geopolitical risk after the attacks in Saudi Arabia).

EUR: Time is ripe for a turnaround

This week, we may start to see a turnaround in EUR/USD, with the pair exploring the area below 1.10. As highlighted last week, we suspect the easing package delivered by the ECB will not be enough to revamp the battered eurozone economy, suggesting a further extension of monetary stimulus and contributing to a weaker EUR/USD. We continue to expect the pair to trade within the 1.05-1.10 range by the end of the year.

GBP: Johnson still seeking a deal

UK Prime Minister Boris Johnson will head to Brussels today to hold talks with EU Commission President Jean Claude Juncker, in one of his latest efforts to agree on a revamped deal before the October 31 deadline. Johnson has continued to oppose the possibility of another Article 50 extension, regardless of the recently-passed legislation to avert a no-deal exit. The pound has been stable in the past few days, but may face renewed downward pressure should hopes of a new deal fall after the negotiations.

AUD: Slowing Chinese economy raises concerns

Weaker industrial output numbers out of China overnight are not good news to the Aussie dollar, which has enjoyed a long rebound in risk sentiment in the past weeks. Tonight, the Reserve bank of Australia will release the minutes of the September monetary policy meeting, which should continue to highlight the Bank's stance in favour of an extended period of low rates, with no detail about the timing of the next rate cut. Our economics team is not expecting more cuts by year-end, but we maintain a bearish bias on the AUD.

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