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FX

FX Daily: Risks skewed to a stronger dollar

The dollar has taken note of Kevin Warsh s hawkish speech last Friday and looks to be holding onto gains. The renewed spike in energy prices only adds to the hawkish trend priced across money markets and again appears to be dollar-supportive. Elsewhere, after a dovish hike from the Reserve Bank of New Zealand earlier, we can see a dovish hold in Canada

The dollar is holding onto gains following Kevin Warsh's dovish speech last week

USD: Fed story will dominate

There remains much focus on the long end of bond markets, where little appetite for fiscal consolidation in recent years seems to be coming home to roost. As Francesco Pesole highlighted yesterday, there remain fears that Treasury Secretary Scott Bessent will dip into his large toolkit again to support the bond market and traders will look to hit a bid in USD/CHF to express the dollar debasement trade.

That is the risk. But the new baseline seems to be that the Fed will, after all, hike rates in September. Fed Chair Kevin Warsh has made it reasonably clear that inflation is not falling quickly enough to target and, given a reasonably strong economy, the Fed will need to act.

Feeding into that story over the next 24 hours will be tonight's release of the Fed's Beige Book and then a moderated discussion tomorrow with the Fed's Christopher Waller. We expect him to emphasise that the Fed looks likely to hike, barring some surprisingly dovish data ahead of the FOMC on 16 September.

We think the cyclical Fed story can trump the dollar bearish debasement theme and some bearish US yield curve flattening can see the dollar advance against the low-yielders – and especially against the Swiss franc, given that Swiss policy rates look most anchored near zero. If we are wrong and are underestimating the pressure on the long end to sell off, then the yield curve steepening from the long end can probably drag the dollar a little lower even as high-yield FX underperforms amidst higher generalised volatility.

US data today sees the monthly ADP employment print and Durable Goods Orders. Based on Warsh's speech on Friday, it seems even weak labour market data may not be enough to stop the Fed from hiking.

We favour DXY grinding higher to the 100.10/20 area and probably moving a little higher tomorrow on the Waller event.

Chris Turner

EUR: Headwinds grow

Higher energy prices and, in particular, a more hawkish Fed have seen EUR/USD swing lower in recent ranges. Below 1.1565/70, EUR/USD can extend its drop to the 1.1520 area and we think something like 1.15 looks an appropriate target for month-end. Higher energy prices continue to drag ECB tightening expectations higher, with currently another 80bp of tightening priced by next summer. Our team feels that is highly unlikely. Yet, the market will be reluctant to take the other side of that trade until there is more clarity on events in the Middle East.

Elsewhere, EUR/CHF is trading above 0.94 as higher oil prices drive euro interest rates higher against more anchored Swiss rates. More hawkish commentary from Warsh also returns us to June-style trading conditions of more credible Fed policy weighing on the Swiss franc, gold and bitcoin. Barring new drama at the long end of bond markets, expect USD/CHF to challenge July highs near 0.82.

Chris Turner

JPY: BoJ hawks remain in the minority

USD/JPY is a little lower in early Europe as one of the Bank of Japan hawks, Hajime Takata, has implied that the BoJ could possibly hike 50bp in September or deliver back-to-back hikes, meaning a further hike in October. Takata has been in the minority as one of the three hawks on the BoJ policy board and his comments should not be particularly surprising. He is a fan of getting the policy rate to neutral at 2.00% quite quickly.

However, a BoJ hike in September would already represent a quickening in the pace of hikes after the tightening in June. And we suspect that after a September hike, the BoJ will prefer to wait until early next year before tightening again to see how weak domestic consumption has performed.

For USD/JPY, the hawkish Fed is a game-changer and suggests USD/JPY can spend much more time in this 160/162 area. Scott Bessent will not be particularly happy with the hawkish Fed working against the yen buying operation, but he will no doubt appreciate the benefits of Fed independence here.

Chris Turner

CAD: BoC on hold amid tariff mayhem

The Bank of Canada is widely expected to keep rates on hold at 2.25% today. We see a very low risk of a surprise hike. While headline CPI rose back to 3.0% in July, core inflation remains very well anchored around 1.9%-2.0%. A few strong jobs market reads and a respectable 3.3% annualised growth in 2Q have been clouded by the latest escalation in the US-Canada trade and diplomatic spat. The Bank of Canada has mostly looked at tariffs as a dampening factor for activity and jobs, and despite retaliatory tariffs from Canada, which can raise prices, the low starting point for core argues against jumping into a hawkish shift just yet.

We suspect Governor Tiff Macklem will stress that monetary policy isn't a corrective tool for trade policies, and keep the door open to some tightening if necessary. But markets are pricing in 27bp of tightening by the January meeting, and may not find too many reasons to revise those expectations after today's meeting (especially since they are primarily borrowed from the USD curve).

As discussed in this note, we remain concerned about the near-term impact on CAD from the trade chaos in North America. The implications for the Canadian economy can be deep even if tariffs are eventually negotiated away, given the impact of trade uncertainty on business spending and hiring plans and well as consumers. Paired with our bullish call on USD, we see USD/CAD upside risks extending to 1.400 this month.

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