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FX

FX Daily: Staring at the geopolitical headlights

FX markets are steady as they absorb the latest geopolitical developments. These include renewed escalation in the Gulf, possible Russia-Ukraine peace talks and far-right success in regional German elections. Resilient growth and high energy prices mean 60-90bp tightening cycles remain priced across major economies. The dollar can stay supported

USD: Should be doing a little better

High energy prices and an above-consensus August NFP reading mean the dollar should really be doing better than it is. The fact that it is not probably owes to the still constructive investment environment, where global equity markets, including emerging markets, continue to perform well. In fact, of the various correlations we monitor, the inverse correlation between global equities and the dollar seems to be the strongest right now – far higher than the dollar's link to oil prices.

The dollar has also had to contend with last week's big drop in USD/JPY, where it looks like global macro accounts are speculating on some kind of grand bargain in September or October, where faster Bank of Japan tightening is backed up by a portfolio shift towards more domestic assets by the $2trn GPIF national pension fund. Here, we continue to see 155 as a big level in USD/JPY, above which some more consolidation should be due.

Looking ahead this week, the US macro focus should be on Friday's August CPI data, where month-on-month readings at 0.4% and 0.2% for headline and core should be enough to sway the Fed towards a 25bp rate hike on 16 September. This is just priced with a 58% probability at the moment. The US Treasury market will also be in focus, given $119bn auctions of three, 10 and 30-year bonds. Wednesday also sees the start of the US Treasury's slightly controversial buy-back operation of longer-dated Treasuries, where any Treasury weakness stands to weigh on the dollar.

We prefer to back the themes of higher energy prices and an under-priced Fed giving some support to the dollar in the near term. The US Labor Day public holiday will limit activity today, but DXY can probably drift higher in a 99.00-99.50 range.

Chris Turner

EUR: Contained

While not a major negative for the euro, Sunday's election results in Saxony-Anhalt will serve as a reminder of the declining popularity of Chancellor Merz's CDU party, and, if backed up by similar results in two further regional elections, raise tensions within the governing coalition. So far, the German government's infrastructure and defence spending plans seem to be paying dividends for German growth prospects and international investors will not want to see those interrupted.

On the subject of growth, today should see eurozone second-quarter growth confirmed at a decent 0.4% quarter-on-quarter figure and also see another decent increase in the Sentix investor confidence data. The main event of the week, however, will be Thursday's ECB meeting, where we see some downside risks to the euro. Expect EUR/USD to trade a tight 1.1580-1.1640 range today, with our bias to the downside.

Elsewhere, UK Chancellor John Healey makes his first big speech today and will be prepping markets for the budget on 28 October. Expect him to emphasise fiscal sustainability today, but it will be hard for him to conjure up many meaningful pro-growth measures. 0.8580-0.8610 should contain EUR/GBP for the time being.

Chris Turner

CEE: Hawkish pricing meets dovish central banks

With the start of a new month, the CEE calendar is again packed with local events. Today brings July industrial production data from the Czech Republic and Hungary. Tomorrow, Hungary releases August inflation, which we expect to edge up from 1.2% to 1.4% after several months of disinflation. On Wednesday, we expect the National Bank of Poland to keep rates unchanged at 3.75% and remain on hold for the rest of the year. Following the governor's dovish remarks in July, inflation has risen over the past two months, effectively closing the door to a near-term rate move.

On Thursday, the Central Bank of Turkey is also likely to hold rates at 37%. We believe it will wait before resuming cuts after restarting repo auctions two weeks ago, which lowered the effective market rate. Finally, Romania's August inflation is due on Friday. We expect it to fall sharply from 8.2% to 6.5% year-on-year, largely due to base effects, despite some acceleration in monthly price growth. In the Czech Republic, the CNB blackout period starts on Thursday and we should see more headlines from the bank board in the coming days. We expect a more dovish tone versus aggressive hawkish market pricing.

Regional rates rallied last week after global relief, reducing expectations of rate hikes in the Czech Republic and Poland. Even so, markets still price around 80bp of tightening in both countries, which we view as excessive. A further unwinding of these bets should narrow interest-rate differentials and weigh moderately on CEE currencies. We therefore see upside risks to EUR/CZK, which could move back above 24.250 unless the CNB delivers a hawkish surprise this week. EUR/PLN also appears to have reached a local low and could rise if the NBP maintains its dovish bias despite higher inflation.

Frantisek Taborsky

KRW: Too far, too fast

USD/KRW bounced off the lows today at 1335 after news emerged that Korea's National Pension Service could be halting, if not reversing, its USD/KRW sales in the forward market. Remember, changes to NPS FX hedging were one of the measures introduced in June to help support the beleaguered won. Today's news suggests Korean authorities feel that the won has come far enough for the time being. And certainly the 15% drop in USD/KRW since June has been impressive and matches a similar move seen in 2022.

We tend to favour some consolidation both in USD/JPY and USD/KRW for the time being. And the easing of dollar selling pressure in these two big FX pairs can allow the dollar to find support more broadly.

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