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FX Daily: Dollar price action quite poor

Despite higher energy prices and firm short-dated US interest rates, the dollar remains soft. Wild swings in USD/JPY remain the main event, but the benign, low-volatility investment environment is another key factor encouraging flows out of the dollar. The calendar is quiet today and the focus will probably return to US Treasuries ahead of auctions

USD: Dollar should be doing better

Dollar price action this week has been a little disappointing/confusing. Higher energy prices due to an escalation in the Gulf will direct more trade flows towards the US at the expense of Europe and Asia. At the same time, US short-dated rates remain relatively elevated as they await Friday's US August CPI release – what should be the final piece of the puzzle for the Fed's policy decision next week. We are expecting a 25bp Fed rate hike.

The fact that the dollar is not stronger may be attributable to both the investment environment and to developments in USD/JPY. On the former, global equity markets remain near their peaks as the AI investment boom keeps global growth relatively resilient. As mentioned earlier this week, one of the tightest FX correlations out there is the negative one between equities and the dollar. A very fragile USD/JPY is probably also contributing to the dollar malaise, as global macro hedge funds position for a downside break of 150 over the coming months on expectations that Japanese policymakers will deliver on their side of some grand bargain with Washington.

There is also the question of whether buy-side investors are quietly raising their dollar hedge ratios. Certainly, the most recent data we have seen this summer suggest the European buy-side has been running relatively low FX hedge ratios on US assets – a position which could be challenged in investment committee meetings as they consider more activist US Treasury policy. On that front, the bond market will be in focus today as the US Treasury starts its buy-back operation of longer-dated Treasuries, plus auctions $39bn and $22bn of 10 and 30-year bonds today and tomorrow, respectively.

We don't fully understand why the dollar is not reacting to higher energy prices and do not see a strong case for DXY to immediately break support at 98.55/65. If it were to break, we suspect USD/JPY would be the driver, and a quick drop in DXY to 98.00 could be seen.

Chris Turner

EUR: Mid range

Near 1.1600, EUR/USD is sitting approximately in the middle of its range seen since April. As above, we would have thought that the clear decline in the euro's terms of trade would be an important factor weighing on EUR/USD this week. The fact that it is holding up quite well probably raises more questions for the dollar.

Our team published their ECB cheat sheet yesterday. Unlike the market, we are looking for a dovish hike – or at least a hike which does not support the additional 50bp of tightening priced in after Thursday's expected 25bp move.

The eurozone calendar is very quiet today. We do not quite see a justification for EUR/USD to break above resistance at 1.1640/45, but if so, 1.1675/80 beckons. At present, we prefer a 1.15 end-September target on the back of a Fed hike.

Chris Turner

PLN: Hawkish pricing leaves room for correction

We expect the Polish central bank to keep rates unchanged at 3.75% today, as renewed tensions in the Middle East and higher oil prices leave little scope for easing. National Bank of Poland Governor Adam Glapiński sounded dovish in July and was open to post-summer rate cuts. However, subsequent developments suggest his inflation outlook was too optimistic, with inflation likely to rebound towards the upper end of the tolerance band later this year.

The Polish market shifted hawkish in August alongside global markets and now prices around 80bp of tightening, similar to the Czech Republic. However, the Czech National Bank remains notably more hawkish than the NBP. Unless the NBP surprises today or tomorrow, some repricing is likely. Oil and gas prices will continue to support hawkish bets, but a partial dovish correction could lift EUR/PLN back above 4.330 soon.

Frantisek Taborsky

BRL: Narrowing polls help the real

USD/BRL is drifting towards the lower end of its two-month range at 5.05/5.07, helped by the latest opinion polls for October's presidential election. For the first time yesterday, a poll put challenger Flavio Bolsonaro ahead of President Lula in a second-round run-off. Polymarket still shows President Lula's chances of winning as some 7% ahead of Bolsonaro, but the gap is closing fast. Those overweight the Brazilian real will be hoping for some kind of Colombian peso-style advance should Bolsonaro be successful and bring in some fiscal consolidation and deregulation.

Clearly, the benign global investment environment is also helping the real, which is backed by one of the highest real interest rates in the world. At the very least, we look for the real to continue outperforming the steep forward curve, if not deliver nominal appreciation should the polls shift even further to Bolsonaro.

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