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FX Daily: Dollar is on a roll

The dollar remains very well bid and the DXY dollar index is close to the highs of the year. Yesterday s softer-than-expected August US PCE inflation data barely put a dent in Fed tightening expectations, perhaps because US activity data continues to come in on the encouraging side. EUR/USD is testing the lows of the year and looks vulnerable



The dollar is testing the highs of the year and could go higher

USD: Activity data backs up the Fed's hawkish position

The DXY dollar index is testing the highs of the year at 101.80. Dollar debasement fears have been set aside for now as the cyclical story takes centre stage. Here the US economy is performing reasonably well and the market prices the need for the Fed to take policy into restrictive territory. Even a seemingly more docile US PCE inflation print for August, released yesterday, did not depress short-dated US interest rates for long. For example, the one-month USD OIS rate priced one year forward briefly came off 5bp on the data release, but had retraced the entirety of that dip by the end of the US session. Firming up the view that the Fed will need to tighten again has been the activity side, where consumer spending data is holding up and there are even signs that payroll growth is accelerating again – this from the monthly ADP report released yesterday. All eyes will once again be on tomorrow's September nonfarm payrolls release.

Today, the US focus will be on the weekly initial claims data and the ISM manufacturing data.

The sense is that the AI investment boom is seeping into broader parts of the US economy and a healthy 55 headline reading is expected for the index, alongside firm prices paid, new orders and employment figures.

Also on the calendar are a raft of Fed speakers. The only Fed voters speaking today are Neel Kashkari (1330CET) and Chris Waller (1600CET). Kashkari is now a noted hawk, but Waller's remarks should be more interesting should he stray away from today's subject of Fed economic data and into the realms of monetary policy.

Barring some breakthrough in US-Iran negotiations, it looks like the dollar will stay bid in October. For reference, DXY has appreciated in seven of the last 10 Octobers. Expect DXY to remain bid in a 101.50-101.80 range today, but an upside breakout is a possibility should tomorrow's US data surprise on the upside or should the sell-off in European government debt start to heavily weigh on the euro (see below).

Chris Turner

GBP: The Burnham bounce?

EUR/GBP has come noticeably lower this week. One could argue that independent euro weakness is starting to emerge here given that the usual hedge for eurozone political/budgetary risk, EUR/CHF, is being heavily driven by the rate spread story. But at the same time, we have heard a powerful speech from UK Prime Minister Andy Burnham in which he said he wants to formally start a debate on whether the UK should be moving much closer to Europe – including potentially pushing to rejoin the EU after the next election (due by 2029 at the latest). Whether a Labour win in that election would be enough or a separate referendum to rejoin would be required remains to be seen.

Any move by the UK to rejoin the EU would likely be seen as a positive by the foreign exchange market, having witnessed sterling's crash following the Brexit vote in 2016. Obviously, we are years away from any clarity here, but let's see whether sterling catches a bid into a supposed UK-EU summit due around 20 November.

Chris Turner

EUR: French debt sell-off must be a concern

As yet, it is hard to identify that the sell-off in French debt is being priced into the euro. EUR/USD has been driven to the lows of the year by the hawkish reassessment of Fed policy rather than any independent euro weakness. But the French OAT-German Bund spread widening so quickly to +127bp is quite an alarming move – potentially adding some risk premium into the euro as well as constraining the ECB's tightening cycle.

That OAT-Bund spread will be in focus today now that the French government has presented

its plan to save EUR54bn and target a budget deficit at 5.0% of GDP next year. Have a look at a useful piece on this subject here.

On the subject of the ECB, we hear from Joachim Nagel, Christine Lagarde and Isabel Schnabel among others today. Expect them to hold the hawkish line for the time being, but the chances of the ECB 'out-hawking' the Fed seem slim at this stage.

1.1300/1320 may feel like the bottom of the range in EUR/USD. But if the OAT-Bund spread widens much further and US data stays strong, we will have to prepare for a drop into the 1.11-12 area.

Chris Turner

CEE: Inflation clues and Romania's market test

Poland's September inflation rose from 3.4% to 4.0% yesterday, in line with expectations. The details offer two key takeaways: we estimate that core inflation eased from 3.3% to 3.0-3.1%, while food prices stabilised after five months of decline. Softer core inflation gives the National Bank of Poland room to wait, supporting our economists' view that the first rate hike will come only early next year. Still, November will be pivotal, as the central bank's new forecasts could open the first window for a hike. The stabilisation in food prices also offers a signal for next week's inflation releases in the Czech Republic and Hungary, where food prices, as in Poland, have kept inflation lower this year.

Today, we are watching PMI data across CEE, which have shown relatively resilient industrial sentiment since the US-Iran conflict began. In Romania, another attempt to form a government failed yesterday, after which the president said he would select the next candidate on 5 October. Despite no clear path to a new government, markets remain stable. EUR/RON slipped from 5.280 towards 5.270 yesterday as part of a broader global relief rally. The key test, however, will be S&P's sovereign rating review on Friday.

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