Dollar powers ahead as Fed stays the course

The dollar is once again powering ahead as the Fed cements expectations of a December hike

Source: iStock

USD: Powering ahead yet again

The decline in the US dollar after the mid-term elections proved very brief. The dollar is again powering ahead (now even Asian FX has joined the emerging markets decline) as the Fed stayed on track yesterday to deliver further gradual rate hikes (see Federal Reserve: On track for a December hike). The December rate increase now seems to be a done deal and our economists look for another three hikes in 2019. With US dollar funding costs rising and the US economic data still solid, it is hard to see a persistent and meaningful USD decline any time soon. Still, as long as equity markets remain supported, we expect emerging market FX high yielders to outperform the euro.

EUR: Supportive factors scarce

It looks like just a matter of time before the EUR/USD breaks the 1.1300 level as there appear few hurdles for further rises in the US dollar and near-term catalysts for a stronger euro are scarce. In Norway, both headline and underlying October CPI inflation measures disappointed this morning compared to market expectations. Coupled with the meaningful decline in oil prices since October, this clearly tames any upside potential for the Norwegian krone and further reduces the probability that Norges Bank should deviate from its current forward guidance of two hikes for next year. EUR/NOK to stay comfortably above 9.500.

GBP: Solid UK GDP won't move BoE pricing much, in turn limiting GBP upside

The focus of the day is the UK 3Q18 GDP. The consensus already expects a strong 0.6% quarter-on-quarter growth rate and UK rates have risen after the central bank's press conference last week. Unless we see a 0.7% QoQ print or higher, it will be difficult to see GBP/USD push towards 1.3200. The Brexit overhang (although rumblings about a deal appear to have risen in recent days) should limit further hawkish re-pricing of the UK curve as it looks very unlikely that the Bank of England will hike rates before May 2019, at the earliest. Given the limited upside to EUR/USD (with a risk of EUR/USD trading below 1.1300) any tactical bullish GBP view should be expressed via EUR/GBP shorts rather than GBP/USD longs.

CZK: Higher CPI, higher odds of more rate hikes but no CZK strength

Our economists look for above-consensus October Czech CPI, expecting a rise to 2.4% (vs 2.3% previously) stemming from typical seasonality, solid household consumption, and higher food and fuel prices. Following yesterday's above-consensus drop in the unemployment rate, this should be another piece of a puzzle pointing to the ongoing central bank tightening cycle (we look for three hikes within the next nine months). But expect the upside in the Czech koruna to be limited as the currency is overbought, investors are concerned by seasonal year-end CZK weakness and its sensitivity to rising rates is very muted. We expect any dips to/below EUR/CZK 25.80 to be shallow and target 26.00 by year-end.