

FX Daily: A pivotal week for 2023 themes

A heavy event risk calendar this week stands to define the core themes for 2023. First and foremost is the question of how quickly US inflation decelerates (CPI on Tuesday) and how the Fed will respond (FOMC Wednesday.) A whole host of central bank meetings around the world, including the ECB on Thursday, will provide insights on how long policy stays tight



➔ USD: How long does policy need to stay tight?

A pivotal week for FX and global asset markets lies ahead of us. The week will play a major role in determining whether central banks (particularly the Federal Reserve) need to keep policy tighter for longer, or can (as the market prices) start to relax a little over inflation and can consider rate cuts in the second half of next year to ensure a soft landing. The two key event risks here are tomorrow's US November CPI reading and Wednesday's FOMC meeting - including the release of a fresh set of dot plots.

Going into these event risks the market is pricing the Fed tightening cycle peaking in the 4.90/5.00% area next spring and then 50bp of rate cuts being delivered in the second half. And consensus is for another relatively soft 0.3% month-on-month core CPI release tomorrow, which would tend to support the market's pricing. We look at a range of Fed scenarios in our [FOMC preview](#). As noted previously here, December is typically a soft month for the dollar and probably a more dovish set out of outcomes and a weaker dollar does the most damage to positioning, which is probably still long dollars.

However, we do feel that market consensus still underappreciates the risk of inflation staying higher longer and also is dangerously second-guessing the Fed in terms of 2H23 rate cuts. The Fed has said that it feels there is good forward guidance value in its dot plots and it may choose to get across its current message of tight policy staying in place for longer through those dot plots. Our rates team also sees upside risks to US 10-year yields from the 3.50% area, with outside risk to the Fed discussing outright US Treasury sales (rather than just roll-offs) if it does think the long end of the curve is too stimulative. Notably, the correlation between US 10-year yields and G10 dollar crosses has picked up substantially since the soft October CPI release on 10 November. The long end of the curve is therefore going to be a key battleground for the dollar.

Event risks this week will therefore determine whether 2023 starts with a focus on the inflation battle being won and the prospect of stimulative, reflationary policy coming through - a dollar negative. Or whether sticky inflation ties the hands of central bankers, the US yield curve remains steeply inverted and the dollar continues to perform well in a challenging risk environment. We do see the latter scenario as more likely, but this week should certainly give one of the scenarios a big lift.

There is very little on the US calendar today and we would expect DXY to go into tomorrow's CPI release near its current 105 levels.

Chris Turner

➔ EUR: A big week for central bank meetings in Europe

This week sees central bank meetings in the eurozone, Switzerland and Norway, where 50bp hikes are expected in the former two and a 25bp hike in the latter. Please see our full European Central Bank preview [here](#) and our Swiss National Bank preview [here](#). On the former, we note there is still a slight risk of the ECB doing 75bp rather than 50bp - which would probably help the euro. But this of course comes after the US CPI/FOMC risk. Given the 10% EUR/USD correction off the late September lows, our preference would be that EUR/USD struggles to hold any gains over 1.06 this week and could end the week lower should US events oblige.

Chris Turner

➔ GBP: BoE to hike 50bp this week

This week's highlight will be the Bank of England meeting on Thursday. Please see our full preview [here](#). We expect the BoE to revert to a 50bp hike (55bp hike priced) as it tries to balance high inflation against growing evidence of a prolonged downturn - with little signs of stimulus.

Our game plan assumes that GBP/USD struggles to hold any gains over 1.23, while EUR/GBP should find support in the 0.85/0.86 area. A winter of discontent should see sterling underperform should central bankers need to keep rates tight(er) into a recession.

Chris Turner

➔ CEE: Asymmetric response to global developments

[A busy week](#) at the global level will be accompanied by several data points from the Central and Eastern Europe region. This week's headline number will be November inflation in the Czech Republic. We expect inflation to accelerate from 15.1% to 15.9% year-on-year, slightly above

market expectations. The number will have the market's attention not only because of the Czech National Bank meeting next week but also because of the surprising slowdown in inflation in October when government measures against high energy prices came into play. After this number, we can then expect more headlines coming from the CNB given Thursday's start of the blackout period.

Also today, Hungary's assessment is expected to be discussed at the European Council level. However, early rumours suggest that the European Commission's conclusion remains unchanged. November inflation in Romania will be published on Tuesday. We expect an increase from 15.3% to 16.6%, above market expectations. Although we have already seen inflation slowing in previous months, this result would thus raise the peak again. We do not expect another rate hike from the National Bank of Romania in January, but either way, it will be a close call, and tomorrow's number could be key. In the second half of the week, we will then see secondary data across the region such as the current account balances in Poland and the Czech Republic and the final inflation estimate in Poland, including the core number.

In the FX market, this week we will be watching the impact of global events on the region. Our baseline scenario of a stable EUR/USD should not bring too much change for the region, but risks both ways are significant and higher volatility compared to previous rather quiet weeks in the CEE FX market can be expected. As we mentioned earlier, interest rate differentials have fallen significantly over the past weeks in the region leaving FX vulnerable to global shocks. Also, the gas story is creeping back and with higher gas prices we see growing signs of a renewed relationship with FX. The region's reaction would thus be asymmetric in the direction of weaker FX in our view, if the US dollar ends up as a winner this week.

The Hungarian Forint will be following a separate story in addition to the EU developments and the newly lifted fuel caps. Given the negative rumours, more pain for the forint can be expected and the question is whether EUR/HUF will make another march towards the 430 level as it did in October, which led the central bank to an emergency rate hike in the middle of that month. In our view, the long positioning has fully unwound, and the market is leaning towards the short side again, but we don't think that the negative outcome of the EU story is fully priced in, so it is likely that we will test new highs this week.

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