

FX Daily: Another black November for the dollar?

November 2022 was a historically negative month for the dollar, and this month has also started with a correction. Positioning is playing a role and we suspect it may be too early to see the deterioration in US activity necessary to drag USD sustainably lower. This week, FedSpeak may push back on dovish interpretations, while we expect an RBA hike overnight



The US calendar quietens down this week, with the spotlight turning to Federal Reserve Chair Jerome Powell at the IMF conference

➔ USD: This is not November 2022

November was a crucial month for the dollar in 2022. DXY dropped around 5% on the back of a large unwinding of dollar positions as inflation appeared to be easing faster than expected. The first days of November 2023 have also seen the dollar correct lower, this time driven by a bearish interpretation of the Federal Reserve's announcement (which acknowledged tighter financial conditions are hitting the economy) and a set of weaker-than-expected US activity data with payrolls and ISM surveys. Throughout the whole of November 2022, the USD 2-year swap rate had dropped 45bp; in the first days of November 2023, it has already dropped by over 25bp.

We must, however, put all of this into context. The dollar is now less overbought than a year ago,

but positioning in long-term Treasuries was significantly more bearish entering this November. Despite the relation between the dollar and UST yields having faded a bit of late, the sharp drop in 10-year yields seen in the past few days – likely a big squaring of paying positions – inevitably impacted FX.

As FX analysts, we should probably resist two temptations here. One is to rush to the conclusion that the dollar strength is over, and we are witnessing the start of a downtrend. US activity data will be scrutinised even closer now, and determine the direction of travel in FX and likely the broader markets. If a slight softening of the US activity story was enough to trigger a correction in yields after a historical bond sell-off, it may be insufficient to drive another substantial repricing of rate expectations that can drag the dollar sustainably lower. We must also remember that response rates to surveys have been quite low and the quality of the data has declined materially of late, making it less predictable.

We should also avoid the temptation of dismissing this as a mere position-squaring event. The acknowledgement by the Fed that higher rates are having an impact on the economy may now have put a cap on how far yields can rise back, and our economics team is observing a clear [loss of momentum in the employment sphere](#) as well as other parts of the economy. Higher rates and the exhaustion of savings remain key headwinds to consumer spending that has hugely contributed to the US economic resilience.

To answer the title of this FX Daily, we are inclined to think it is still too early to see another large drop in the dollar because the US activity story simply hasn't deteriorated enough. This week, the US calendar quiets down, with only the University of Michigan surveys in focus. There will also be more focus on FedSpeak. We'll hear from Fed Chair Jerome Powell at the IMF conference, along with many other members. Some pushback on the post-Fed dovish market reaction may be on the cards, and could help the dollar recover some ground.

Francesco Pesole

➔ EUR: Rates do not justify such a high EUR/USD

EUR/USD is currently trading at the highest level since mid-September, but the EUR-USD rate and swap spreads have not swung that favourably towards the euro. The two-year swap rate differential is at -120bp, the tightest in only two weeks, and the 10-year sovereign rate differential is still 25-35bp wider than it was the last time EUR/USD was trading at these levels.

These observations add to what we discussed in the USD section above; USD rates still have some way to fall to justify a continuation of the dollar correction. From a EUR/USD perspective, this is especially true considering that euro idiosyncratic support has been scarce, and unlikely to pick up anytime soon in our view. The eurozone calendar is quiet this week, and data has hardly given much help to the euro anyway.

On the European Central Bank side, we may hear some hawkish comments by the members scheduled to speak this week – ECB President Christine Lagarde included – although another hike appears to be a very hard sell to markets at this stage. With no key US activity data this week, EUR/USD may slip back below 1.0700 rather than push higher to 1.0800.

Francesco Pesole

📈 AUD: A hike by the RBA tonight

In line with our longstanding call for the Reserve Bank of Australia, we expect a rate hike overnight. The inflation figures for the third quarter came in hotter than expected at 5.4%, and the monthly CPI year-on-year figure jumped to 5.6% in September. Employment growth has been slow and full-time jobs declined in September, but the unemployment rate has remained very low at 3.6%.

We had expected new RBA Governor Michele Bullock to have a preference towards sending a strong message in her first few meetings. This is the best chance for her to do so given the rebound in inflation: we expect a 25bp increase to 4.35%. For now, our view is that this will be the last hike of the cycle.

Consensus is almost fully aligned with our view for a hike, but markets are pricing in a 50% implied probability. We therefore see upside risks for AUD today. The recent jump in AUD/USD (driven by the USD correction) could extend into the 0.6550/0.6570 area, barring a USD rebound in today's session.

Francesco Pesole

➡ CEE: Central banks and inflation prints in spotlight

Industrial production data in the Czech Republic for September will be published today, which should confirm the weak performance of the economy indicated in previous months and GDP for the third quarter. Tomorrow, we will see industrial data in Hungary and retail sales in the Czech Republic. On Wednesday, the National Bank of Poland (NBP) and the National Bank of Romania (NBR) will meet. We expect another 25bp cut in Poland, but this may be the last one for a while. In Romania, we expect rates to remain unchanged for some time. Inflation numbers will be released on Friday. In the Czech Republic we expect a rise from 6.9% to 8.4% YoY and in Hungary we forecast a further fall from 12.2% to 10.3% YoY. Also on Friday, CNB minutes will be published and Fitch will release Poland's rating review, which should be unchanged, but it will be interesting to see fiscal policy commentary after the election.

The Hungarian forint strengthened below 380 EUR/HUF on Friday, to its strongest level in two months. Part of the strengthening can be explained by the weaker US dollar, and although we are positive on the HUF, the current levels seem premature. The market is still pricing in more rate cuts from the National Bank of Hungary (NBH) and we see the HUF as having significantly detached from the rate trajectory since the last central bank meeting, which in turn indicates a weaker HUF. We see this as unsustainable for the longer term. Therefore, we expect more of a retracement of recent gains and a move back above 380 EUR/HUF.

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