FX Daily: Strong dollar could be challenged by Asia this week

It is another busy week for FX markets, with important central bank meetings taking place around the world and some top-tier macro data too. On paper, there should not be enough out there to knock the dollar's dominance this week, but focus on the US quarterly refunding could throw some curveballs

USD: Gearing up to Wednesday's FOMC meeting

The dollar continues to trade on the strong side and this week faces local event risks in the form of the FOMC meeting on Wednesday and the nonfarm payroll report on Friday. As discussed in our Federal Reserve preview, we expect the dollar to hold gains unless the Fed feels the need to emphasise the tightening of financing conditions and drop its tightening bias. That seems premature. Equally, unless Friday's jobs report dramatically misses estimates, the dollar should stay bid. There is also plenty of second-tier US data in focus, where we would highlight tomorrow's Employment Cost Index release and Wednesday's JOLTS job opening data and ISM Manufacturing.

In addition to the data, there is also much focus on Wednesday's release of the US Treasury's Quarterly Refunding announcement, where attention will be on the size and the mix of issuance in the three, ten and thirty-year sector of the Treasury market. Recall that the August refunding announcement caused a bit of a stir, especially with the Fitch rating agency downgrading US sovereign debt the day before the refunding announcement. This poses an event risk for the US bond market and could tighten financial conditions still further and deliver risk-off conditions.

Away from the US, we would say that the threat to the dollar this week stems more from Asia than Europe. Tomorrow sees an important Bank of Japan policy meeting, where we think the risks of a policy adjustment and a softer USD/JPY are under-priced. China also releases PMI data mid-week. Europe looks less of a threat to the dollar given what should be a run of soft/recessionary GDP data and lower inflation this week.

DXY sits in the middle of its 105.35 to 107.35 range and should probably trade to the strong side unless some of the above event risks come to pass.

Chris Turner

EUR: GDP data could take its toll

Last week's release of soft PMIs across Europe proved that the euro can still be moved by data. The early part of this week should see plenty of soft eurozone data, be it third-quarter GDP data or the October inflation prints. The consensus for tomorrow's third-quarter eurozone GDP print is 0.0% quarter-on-quarter. This follows releases of 0.2%, 0.0% and 0.0% over the previous three quarters. Presumably, another soft release along with softer CPI data will cement views that the European Central Bank's tightening cycle is over (further hikes have now been priced out) and could leave the euro vulnerable. It is going to require some soft US data to turn this EUR/USD bearish trend around. 1.0500-1.0600 could well be the EUR/USD range this week.

Elsewhere, international investors will be looking at Turkey with renewed interest after authorities softened regulatory restrictions on banks which required them to hold a lot of Turkish government bonds. Even though government bond yields surged on Friday's announcement, the softening of restrictions is seen as another move (along with large rate hikes) towards policy orthodoxy.

Chris Turner

GBP: On the soft side into BoE

Sterling is trading slightly on the soft side ahead of Thursday's Bank of England (BoE) policy meeting. We think a 6-3 vote for unchanged rates should not unduly hit the pound. However, it seems investors are taking a slightly dimmer view of the pound. In the latest reporting week, both asset managers and leveraged funds were net sellers of sterling FX futures contract – and these communities had been buying euros last week too.

A strong dollar should probably keep GBP/USD not far from the 1.2050/2100 support region. Soft eurozone data this week suggests EUR/GBP may struggle to hold gains over 0.8700.

Chris Turner

CEE: CNB starting its cutting cycle, inflation in Poland

The story should return to the region this week. Today's calendar is blank, but tomorrow we will see October inflation in Poland and a flash print of third-quarter GDP in the Czech Republic. In

Poland, we expect inflation to fall further from 8.2% to 6.9% year-on-year, above market expectations. PMIs in the Czech Republic will be published on Wednesday and then on Thursday, we will have PMIs in Poland and Hungary. On the same day, the Czech National Bank (CNB) will meet. We expect the cutting cycle to start with a 25bp move, which is also the market consensus. However, according to the polls, it seems to be a close call. The central bank will also release a new forecast, its last this year. On Friday, inflation in Turkey will be released, where we expect a slight increase from 61.5% to 63.0%. Friday will also see the publication of Moody's sovereign rating review of Romania, but this should be a non-event.

On the FX market, the main focus should be on the CZK, which we expect to strengthen below 24.60 EUR/CZK by Thursday's meeting, indicated by a strong interest rate differential in recent days. On the other hand, if we see the CZK weakening in the coming days due to the global story, this reduces the likelihood of a CNB rate cut, which would ultimately be positive news for the CZK in the end. The delivery of a rate cut itself, which is our baseline scenario, would lead the koruna closer to 25.0 EUR/CZK.

In Hungary, we think the market still has room to price in a new rate cut path for the National Bank of Hungary (NBH), leaving the HUF vulnerable to touch EUR/HUF 386 again, in our view.

In Poland, the inflation number will be the main driver for PLN and in our view excessive bets on rate cuts. A stronger PLN is our highest conviction call in CEE at the moment, however the question is whether the CPI print will offer better buying levels or already initiate a second wave of PLN appreciation. Given our above-consensus call for inflation, we thus see PLN as being rather strong these days.

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