FX Daily: Big PMI day for the euro

A combination of factors are contributing to the strong dollar, and with geopolitical risks on the rise, we believe it may be risky to try and pick a bottom in EUR/USD just yet. Incidentally, PMIs may be decent for the eurozone but grim for Germany, which could be enough for markets to price in more ECB easing

USD: Moderately hawkish remarks from Williams

Yesterday's dollar rally led to a break below the key psychological 1.05 EUR/USD support and an exploration above 107.0 in DXY. We cannot pinpoint one single driver of the dollar move, as that was probably a combination of multiple factors.

Markets are clearly taking the escalation in the Russia-Ukraine war more seriously, which is favouring a broader rotation to haven assets like the dollar. On the macro side, jobless claims unexpectedly slowed, although continuing claims accelerated and both the Leading Index and the Philadelphia Fed Business Outlook disappointed. It was, however, some Fedspeak that likely encouraged dollar buying as New York Fed President John Williams – not usually a hawk – said the US is "not quite there yet" on inflation and that the jobs market needs to cool further for easing.

Today, PMIs across developed markets can set the direction and determine whether the dollar can extend the rally. There has been a clear divergence in activity surveys between the US and eurozone as of late which has underpinned the wide USD:EUR rate differential. Expectations for S&P Global PMIs in the US are for another strong composite read around 54.

We don't think there is much value in overthinking dollar strength at this stage, and barring a good PMI read in the eurozone, DXY looks more likely to consolidate above 107.0 rather than correcting lower in the short term.

Francesco Pesole

EUR: PMIs could disappoint in Germany

If we plot the EUR:USD 2-year swap rate spread (now around 180bp) and EUR/USD spot, we can see that the recent break below 1.050 is not an aberration, but a reflection of the wide policy differential. Crucially, rate spreads have grown in importance for EUR/USD to the detriment of equities, meaning that the relatively supported risk sentiment is not offering any real help to the pair.

Today, we'll see arguably the most important data input for the European Central Bank and the euro: November PMIs. The release has risen from being almost disregarded to a de-facto critical input for policy decision given the Governing Council's greater focus on forward looking indicators of growth. Our economics team's call for the eurozone's composite PMI is 50.2, very close to the consensus view for a flat 50.0 read. We are, however, less optimistic on the German PMI call, where we see risks of a drop below 47.0. Net of a stable eurozone print, another soft German figure could resonate more with investors, and keep the euro pressured.

We expect speculation about parity to intensify now that we've broken below the key 1.050 mark, and while we remain bearish in the medium-term on EUR/USD, a move to parity would take the pair into stretched undervaluation territory – as discussed in this note.

Francesco Pesole

GBP: Further downside potential for EUR/GBP

EUR/GBP can show some nice moves around the release of PMIs, as that can impact the perceived growth differential driving the pair. We expect UK composite PMIs to stabilise around 51.8, which may add some pressure to EUR/GBP if, as we expect, German PMIs have a negative impact on the euro.

This morning, we have just seen the release of October retail sales. The figures show a negative surprise in the extent of the month-on-month decline and at the same time the October figures have been revised downwards. Market opening suggests slight GBP weakness, however, we continue to see rather downside risks in EUR/GBP beyond the 0.8300 mark soon.

Francesco Pesole

CEE: Remaining bearish on the region

The calendar for the end of the week is empty in the CEE region and the focus will instead be on PMI data in Europe. EUR/USD found new lows yesterday, adding pressure to FX in the region. Moreover, we see FX starting to recouple with rate differentials again, which narrowed mainly in Poland in last week but also in the Czech Republic yesterday. FX will therefore remain under pressure in our view, especially if we see a negative surprise in PMI today.

Economic data in the region continues to surprise to the downside and further negative news from abroad would only further undermine confidence in the region. We therefore remain bearish on the region as a whole. CEE currencies are losing ground significantly this week and underperforming across the EM space. In our view, they are just catching up with the previous lag behind the rest of the world, where they were more or less stable after the US election result. However, we think there is still room for further weakness for this reason.

Frantisek Taborsky

Authors

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com