

## FX Daily: Caught between stagflationary and reflationary forces

FX markets remain very choppy. On the one hand, energy prices are high and the threat of Israeli retaliation against Iran risks unleashing stagflationary forces. On the other, central banks are cutting rates and we haven't heard the final word on Chinese fiscal stimulus. On balance, expect defensive positions to win out and the dollar to stay bid



The risk of an oil shock on the back of Israeli retaliation against Iran is clearly a stagflationary one for the global economy

### USD: Awaiting the Fed minutes

The dollar is staying relatively bid as the market digests the factors that have driven it 2% higher this month. These have largely been the intensifying conflict in the Middle East and September's surprisingly strong US jobs report. The risk of an oil shock on the back of Israeli retaliation against Iran is clearly a stagflationary one for the global economy and has already seen the US 2-10 year Treasury curve bear flatten by 20bp since late September.

Bearish flattening of the curve is dollar-positive and normally sees the activity currencies hit the most. Yes, the dollar is the strongest G10 currency since late September followed by the defensive Swiss franc, but the third strongest is the Australian dollar. The fact that the Aussie is not at the bottom of the pack owes to developments in China. Here, the reflationary monetary policy enacted by Chinese policymakers two weeks ago – and still the lingering prospect that China will deliver fiscal stimulus after all at an announcement this Saturday – is proving to offset

developments in the Middle East. Additionally, central banks elsewhere in the world seem committed to lowering interest rates. Overnight the Reserve Bank of New Zealand (RBNZ) cut rates by 50bp as [Francesco Pesole expected](#).

The RBNZ also delivered a line in its press release which we think makes a lot of sense. The "current market pricing of risk is especially sensitive to downside economic surprises". With fears of slower growth building and the Middle East situation still very dangerous, equity markets look at risk. Daily FX correlations with the S&P 500 index this year show cross rates such as EUR/JPY and AUD/JPY as the most correlated. The Aussie could see some support from news out of China, but we would have thought this current EUR/JPY rally stalls in the 163/165 area and could break under 155 should the Middle East situation escalate. Equally, the dollar would stay bid buoyed by US energy independence and dollar liquidity.

Today, there is little data of note but tonight sees the release of the September FOMC minutes when the Fed cut 50bp. The market has already scaled back around 30bp from the 2024 Fed easing cycle over the last few weeks but equally we doubt investors are in the mood to re-price an aggressive Fed easing cycle just yet. Additionally, the risk of a 0.3% month-on-month September core CPI release could also prove a mild dollar positive. In short, there are not enough factors to call for a lower dollar in the near term and DXY can continue to press 102.60 with risks to 103.35.

*Chris Turner*

## ⬇️ EUR: Remaining vulnerable

EUR/USD is showing no inclination to trade back above 1.10. Normally we would argue that the prospect of fresh Chinese fiscal stimulus would be a euro positive – given the eurozone's relatively large share of exports to GDP. However, the Middle East situation and the threat of higher oil prices is a large euro negative and one which will hold the euro back this month.

We are disappointed that the EUR/USD rally stalled at 1.12 this Autumn and instead, 1.08 seems far more probable than a retest of 1.12. We continue to flat-line our multi-quarter EUR/USD forecasts at 1.10 until the outcome of November's US presidential election is known.

There is very little on the eurozone calendar today and while EUR/USD may press 1.10 on the back of this morning's news out of China – the Ministry of Finance will brief on fiscal policy this Saturday – we suspect sellers to emerge there.

*Chris Turner*

## ➡️ GBP: No real signs of independent weakness yet

The UK press is starting to reach a fever pitch with its speculation over what Chancellor Rachel Reeves will present in her first budget on 30 October. Critics argue that the budget should have been presented earlier, which would have prevented this policy void from being filled by other news. Investors remain on the lookout for any signs that the UK Gilt market is becoming nervous again about potential spending plans. True the 10-year Gilt-Bund spread has widened 25-30bp over the last month, although that may be as much down to miserable eurozone data than anything else. Equally, the five-year UK sovereign CDS has barely budged from a very tight 21bp – suggesting that there has not been a risk premium going into UK asset markets.

That said, it is becoming increasingly clear that the dollar will now stay a little stronger into US

elections in November. This means we have not seen the lows for GBP/USD. A correction towards the 1.29 area seems probable in the coming weeks.

*Chris Turner*

## CEE: First signs of recovery

Yesterday brought the first significant strengthening of CEE FX this month after the recent sell-off. Although the EM space remains under pressure, it seems the CEE region just needed a few days of calm to start fading the move. Leading the strengthening was the forint supported by market whispers of a hawkish National Bank of Hungary, but gains were visible across the board.

The calendar in the CEE region again has little to offer today apart from the scheduled speech of the Hungarian PM to the European Parliament. However, we have already seen some headlines from the pre-session briefing yesterday. Overall, it seems that all the market needs at the moment is calm.

Although there are few global events on the schedule, geopolitical risks and potential escalation in the Middle East remain concerns. Therefore, we remain cautious but are gradually becoming more bullish on CEE currencies. As we mentioned previously, local fundamentals in our view remain strong given that the market has priced out much of the central bank easing across the region. Interest rate differentials post the sell-off are at record strong levels for CEE FX, which we think should be a key driver if the global story remains muted.

*Frantisek Taborsky*

### Authors

#### **Chris Turner**

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### **Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

#### **Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.