FX Daily: China provides some respite from dollar strength

We should see little action before a busier second half of the week in the US and eurozone. If anything, the USD should see some support ahead of tomorrow's inflation numbers. Inflation numbers in Hungary and the Czech Republic dominate the EM space

USD: China respite

The dollar was a little softer against most currencies on Monday after Chinese policymakers said they would boost consumption 'forcefully'. This will be music to the ears of President-elect Donald Trump who is seeking to reverse China's $300bn trade surplus with the US. The news particularly helped China-centric currency pairs such as the Australian dollar and the South African rand. Expectations of some more detailed Chinese policy measures on Wednesday and Thursday this week can probably prove slightly supportive for the Rest of World currencies.

For today, the US data calendar is light and the focus should be on some slightly better small business optimism embodied in the NFIB index. We doubt investors will want to chase the DXY too much lower ahead of tomorrow's US CPI number and would expect support at 105.40/60 to hold on a closing basis.

Chris Turner

EUR: Waiting for the ECB to show the next direction

Germany's final inflation numbers brought no change to the headline number published previously with November unchanged at 2.2% year-on-year. Industrial production in Italy is also unlikely to make much difference to ECB pricing for Thursday's meeting. Here, a 25bp rate cut seems a done deal for the market, although our economist believes the press conference may open up the discussion for more cuts later, implying a dovish outcome for EUR. In the headlines today we could see the results of the two-day Eurogroup meeting of finance ministers. Otherwise, it should be a quiet day similar to yesterday with the focus on Thursday's ECB meeting.

Still, given some rebound in US rates while the EUR side remains muted, we saw some widening of the rate differential yesterday after more than a week of tightening spreads, indicating some reversal in EUR/USD. The pair bounced down after touching 1.060 yesterday with a close at 1.055, indicating some willingness to go lower after some positioning adjustment in recent days. However, for more action here we will have to wait for Thursday's ECB meeting, which should show the next direction.

Frantisek Taborsky

HUF: Good signs of relief

Inflation numbers from Hungary this morning should show an increase from 3.2% to 3.8% YoY, slightly above market expectations, and in line with the National Bank of Hungary (NBH) forecast. Although at first glance inflation developments in Hungary look favourable for the central bank, we think they will be of little relevance for next week's meeting. Nevertheless, Hungarian inflation remains the only downside surprise within the CEE region. Still, EUR/HUF has the main attention.

Friday's rating outlook upgrade from negative to stable from Fitch brought visible relief to the HUF yesterday and we believe the currency has put the worst behind it. Positioning seems already strongly on the short side at the moment, while Hungarian government bonds have seen new inflows in recent days. Moreover, December is seasonally positive for EUR/USD and CEE currencies, which could provide some relief after two months of stress in the HUF market.

Although in the medium term we believe EUR/HUF will grind further higher towards 420, tactically by year-end short positions could see some profit-taking. At the same time, the market is pricing in little NBH easing in the coming years following the sell-off in November with two to three 25bp rate cuts, which is significantly less than we forecast. Thus, yesterday's signs of calm in the HUF market could indicate a broader rally in HUF assets into year-end with attractive valuations.

Frantisek Taborsky

CZK: Inflation risks are building up

We will also see inflation numbers in the Czech Republic later today. Our economists expect a rise from 2.8% to 2.9% year-on-year, in line with the central bank's forecast, one-tenth below market expectations. However, the risks seem to point more to the upside. On the other hand, we expect core inflation one-tenth below the Czech National Bank (CNB) forecast at 2.3% YoY.

Headline inflation has rebounded in recent months from the 2.0% inflation target to current levels at the edge of the central bank's tolerance band. Although the Czech National Bank and we expect inflation to fall again next year, inflation risks have been moving up in recent months, making the case for the central bank to turn hawkish.

In an interview yesterday, the CNB's Kubelkova reiterated the governor's statement last week that a pause in the cutting cycle is on the table. For now, we expect a pause in December and February with the Board's intention to wait for a new forecast and the January inflation print confirming a return of inflation to below 3% after the expected rise in November and December.

Given Thursday's start to the CNB's blackout period, we expect several statements from the Board after the inflation print to confirm or deny the possibility of a pause in the cutting cycle at next week's meeting. However, EUR/CZK is already the lowest since September, below the CNB's forecast, and further hawkish headlines can only help lower levels. Overall, similar to the rest of the CEE peers, we expect further tactical gains here before the end of the year but weakening next year due to the geopolitical situation.

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