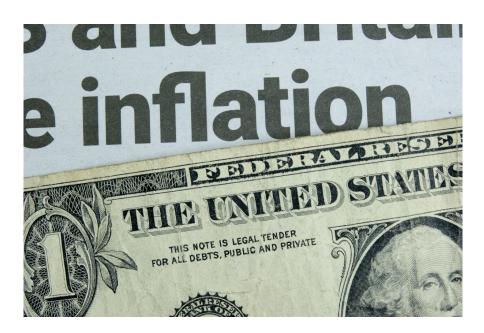


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# **FX Daily: Core issues**

We continue to favour a stronger dollar this week, as CPI numbers should show another acceleration in core inflation, Fed communication should remain hawkish and risk sentiment unstable. The late-September dollar highs are well within reach. Elsewhere, fiscal developments will remain key for sterling, and downside risks remain high



#### O USD: Main narratives point at stronger dollar

Last week's action in the FX market conveyed a clear message that it is too early to turn more structurally bearish on the dollar or bullish on pro-cyclical currencies. This week, markets may find further confirmation that this is the case, with a few key threads to follow.

First, US CPI figures on Thursday should show a decline (we estimate from 8.3% to 8.1%) in headline inflation caused primarily by lower gasoline prices, but at the same time an acceleration in the core rate (we estimate from 6.3% to 6.5%), mainly driven by housing costs and recreation prices. This should all but endorse prospects of another 75bp rate hike in November, even if surveys like the University of Michigan should show an easing in long-term inflation expectations.

Second, Fed communication. A 75bp hike for November and a 4.60-4.70% peak rate are now in the price, but additional hawkish comments – if backed by an inflation surprise for example – could

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encourage markets to speculate on larger hikes or a more prolonged tightening cycle. At this stage, we would see no obvious reason for the Fed to sound any less hawkish. The focus this week will be on the September FOMC minutes and a fairly long list of speakers, starting with Charles Evans and Lael Brainard today.

Third, geopolitical and energy market developments. There have been signs over the weekend that any optimism over an imminent de-escalation in the Ukraine conflict may be misplaced. Meanwhile, fears of potential sabotage across European infrastructure appear to be rising, and with the new EU sanctions on Russia kicking in, it may be a rocky week for energy markets. OPEC+ recent cuts should keep showing their effect on crude prices, and offer some (we suspect, temporary) support to oil-sensitive currencies.

US markets are closed for a national holiday today, so we could see a quieter than usual start of the week in markets. Moving on, we remain bullish on the dollar, as the underlying narrative of a hawkish Fed – paired with lingering geopolitical and energy prices concerns – should keep risk sentiment weak and safe-haven flows into the greenback strong. A re-test of the 114.76 September high in DXY is our base case over the next few days.

Francesco Pesole

#### EUR: Back to 0.95 soon?

There are no major market-moving data releases in the eurozone this week, although Friday's trade figures for August will be quite interesting to watch, and may trigger some market reaction. A trade surplus of €20bn per month turned into a deficit of around €40bn in July due to the rise in energy prices: our economists expect this deficit to have widened to €45bn in August.

This is a testament to how the energy crisis is forcing a radical shift in the export-oriented economic framework of the eurozone, a theme - among others - that in our view will prevent a rapid return to above-parity levels in EUR/USD. After all, our BEER FX equilibrium model has consistently shown that the EZ-US terms of trade (price of exports divided by price of imports) differential is the primary determinant of real EUR/USD medium-term swings, and currently shows that the pair is not undervalued.

On the ECB side, expect a plethora of speakers this week. President Christine Lagarde is scheduled to speak on Wednesday, but we'll hear from Mario Centeno, Pablo de Cos and the chief economist Philip Lane today. Like the Fed, it's hard to imagine the ECB would want to radically change its hawkish rhetoric at this stage. But unlike the Fed, tightening by the ECB is not helping its domestic currency, and we see EUR/USD staying offered into the 0.9540 September lows this week.

Francesco Pesole

## 🖰 GBP: Eyes on Truss' reconciliation effort

UK Prime Minister Liz Truss is set to attempt a reconciliation with the different groups of the Conservative Party after the fiscal-related market turmoil and a fall in opinion polls appear to have generated widespread discontent within the party. Markets will keep a close eye on whether this will lead Truss to backtrack on some of her other fiscal views (like a windfall tax on energy firms).

Barring truly encouraging news on that front, sterling still looks on a slippery slope, as domestic

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and external deficit concerns as well as the risk of more turmoil in the gilt market have made GBP more exposed to adverse risk sentiment swings. Combining our view for a stronger dollar, we expect cable to easily slide through the 1.1000 support very soon, and to stay on a downward trend into the new year.

On the data side, tomorrow's jobs data will be the highlight of the week. Our economists expect the unemployment rate to notch a little higher again, but for now, the Bank of England will keep viewing this through the lens of worker shortages. We expect a 100bp hike in November.

Francesco Pesole

## O NOK: Inflation surprise no big help to the krone

This morning's data showed that Norway's inflation unexpectedly accelerated from 6.5% to 6.9% in September, with underlying price pressures remaining significant (from 4.7% to 5.3%). Higher inflation and a stronger oil market may start to trigger speculation over a more aggressive hike by Norges Bank before the end of the year. For now, our view is that the Bank will stick to a 50bp increase for November, and decelerate to 25bp in December, but risks are clearly skewed to the hawkish side of the spectrum.

NOK didn't react strongly to the CPI figures this morning, and like for other pro-cyclical currencies, domestic rate expectations are not a primary driver of the currency at the moment. Recent OPEC+ action to support oil prices has offered some support to the krone, but should the net impact of higher oil prices be mostly detrimental to risk sentiment, expect NOK's benefits to shrink rapidly. We expect EUR/NOK to remain above 10.40 in the near term, with risks tilted to the upside.

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