

## FX Daily: Dollar corrective forces at work

The dollar is having one of its deepest corrections of the year. Yesterday's smaller-than-expected hike by the Bank of Canada has given rise to speculation that the Fed may also want to slow the pace of tightening. Softer-than-expected 3Q US GDP numbers later could see the dollar correct a little further. But the highlight today should be a 75bp ECB hike



### ➔ USD: Focus on US GDP numbers

Volatility remains the name of the game and the dollar is now seeing one of its deepest corrections of the year. If we were to say what drove dollar weakness yesterday, we would highlight: i) quite a sharp turn lower in USD/CNY where there had been reports of Chinese state banks selling (quasi intervention?) and ii) the smaller than expected Bank of Canada (BoC) rate hike by 50bp.

On the latter, it does seem that the BoC is a little hesitant to power ahead with 75bp rate hikes, noting the slowing economy. This has raised speculation that the Fed may not be as immune to economic weakness as it claims. Somewhat surprisingly, the pricing of the Fed terminal rate is only 15bp off its recent highs at 5.00%. This suggests the FX market has reacted more than the rates market.

That brings us to today where we will receive third-quarter US GDP data. My colleague, James Knightley, believes there are [downside risks to the consensus figure of 2.4% QoQ annualised](#) given softer residential investment and consumption. Such an outcome could feed the corrective forces currently at work for the dollar. That could possibly see the DXY correction extend all the way to the 100-day moving average at 108.42.

However, some high US inflation data tomorrow and what should be a hawkish Fed next week should contain the depth and length of this dollar correction. And for those corporates with dollar needs over the next 3-6 months, this correction should be a good opportunity to secure dollars. As an aside, we noted reports of record US crude and refined product exports last week. That will help keep the US current account deficit in check.

*Chris Turner*

## ➔ EUR: A hawkish ECB has not helped the euro so far this year

The European Central Bank is expected to hike rates by 75bp today, which will bring the deposit rate to 1.50%. Money markets price the deposit rate being taken to 2.75% in a year's time. Our team thinks the top in the cycle will be more like 2.25%, but with Eurozone CPI running at 10% it is too early to expect the ECB to push back against such pricing.

As my colleagues discuss in their [ECB preview](#), beyond any discussion on the terminal rate, the focus will be on i) excess liquidity and ii) Quantitative tightening (QT). On the former, source stories suggest the ECB may adjust the terms of the existing TLTROs (making borrowing rates less advantageous) as opposed to some kind of reverse tiering which could depress available deposit rates. This makes sense in that the ECB will not want to depress money market rates as it fights inflation. On the QT side, our team feels it is too early to provide too many details on QT, where a wind-down of the ECB balance sheet could hit peripheral debt markets.

What does this all mean for the euro? As my colleague Carsten Brzeski noted in that ECB preview, the ECB has surprised hawkishly all year - but EUR/USD has generally ended ECB policy days weaker. It feels like investors use the liquidity provided around ECB event risk to offload euros. As noted above, we have a slightly softer environment today and EUR/USD has firmly broken out of this year's bear channel. That could point to EUR/USD risk on the day to 1.0200. If EUR/USD does find something bearish in the release, ideally it would now need to break back below the 0.9920/0.9950 area to return us to the bear trend.

*Chris Turner*

## ➔ GBP: Recovery moves into the hard yards

Sterling continues to enjoy a renaissance, but we would argue that further gains will be harder to come by. The fiscal credibility premium has reduced substantially, and increasingly the markets will be left to focus on the UK fiscal/monetary policy mix. Here the delay in the release of the government's fiscal plan to November 17th serves as a reminder that there is a lot to play for. Does the delay signify greater cost-cutting at work or will the use of lower gilt yields and lower gas prices in the Office for Budget Responsibility (OBR) estimates mean that the Sunak government has to do less cost-cutting overall?

Where the ground looks slightly firmer is on the Bank of England (BoE) side. Here a recent speech

by the [BoE's Ben Broadbent](#) makes the case that the BoE does not need to respond as aggressively as the markets have priced to government spending plans. In effect, this is a push-back against the aggressive pricing of the BoE cycle. And if there is a risk to the consensus of the BoE hiking 75bp next week, it's that it merely rises by 50bp.

The softer dollar environment means that the GBP/USD correction could extend to the 1.1750 area - but we doubt these gains last. EUR/GBP may well find support in the 0.8600/8650 area, with risks tilted towards 0.8800 into next week.

*Chris Turner*

## ➔ CEE: ECB may spoil the party in the region

The Central and Eastern Europe (CEE) region continues to seek new local currency gains thanks to a combination of new highs in EUR/USD, gas prices staying below EUR 100/MWh, elevated rates and risk-on sentiment in the markets. This saw the Polish zloty reach its strongest levels since late September and the Hungarian forint test the recent highs. The Romanian leu also looked stronger, breaking significantly away from central bank intervention levels for the first time since the summer. We see similar buying interest in the ROMGB market, but we think it is too early to consider this the same scenario as we saw in the summer.

The Czech koruna is the only currency in the region to remain flat after fresh comments from the CNB, which once again cooled market hopes for an additional rate hike at the November meeting. However, the koruna is well away from the CNB's intervention levels, and our estimates suggest that the central bank has not had to intervene since the September meeting. Today, the regional calendar is empty again and all eyes will be on the ECB, which could threaten the favourable EUR/USD levels for the CEE region and end the positive story of the last two weeks.

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