

## FX Daily: Dollar correction extends

The dollar is around 1% lower across the board after what was seen as a less hawkish speech from Fed Chair Powell softened US interest rates. A softening of China's Covid policy is also helping emerging market currencies today. The relatively large adjustment in US rates and the dollar on Powell's speech probably says a lot about positioning



Federal Reserve Chair Jerome Powell speaking at the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institute, in Washington

### ➔ USD: Overreaction?

The dollar came off sharply late yesterday on comments from Federal Reserve Chairman Jerome Powell which signalled that December would probably be the occasion to shift to a slower pace of rate hikes. The market has been expecting the shift to a 50bp versus 75bp rate hike for a while, although it felt the need to price the terminal rate next summer some 10bp lower at 4.90%. Indeed, US yields came off quite a sharp 20bp across the curve.

We are tempted to say that looks an overreaction in that while Chair Powell did acknowledge the slowing in the pace of hikes, his core message was one of stubbornly high core inflation, particularly in the core services ex-housing category. This category is largely driven by wages and an area where the Fed struggles to see labour supply improving anytime soon. Inputs into this story will come today and tomorrow in the form of the October core PCE deflator and the

November jobs report, respectively.

On the former, consensus expects October core PCE to decelerate to 0.3% month-on-month from 0.5%. This basket is different from the national CPI basket, where the 0.3% MoM release on 11 November triggered a huge drop in the dollar and rally in risk assets. Any upside surprise in today's core PCE reading could see the dollar reverse overnight losses.

In the bigger picture, we continue to take the view that a trade-weighted measure like DXY can hold support levels around the 105 area (or at least will not sustain any break under it). One challenge, though, is the EM picture. If we are seeing a sea-change in China's Covid stance – e.g., a shift to home quarantine from city lockdowns, EM currencies may be due a re-rating.

On the day then, the core PCE inflation data is the biggest input, and we prefer DXY to find support near 105.00.

*Chris Turner*

## ➔ EUR: 1.05/1.06 is the risk for EUR/USD

EUR/USD weakness in late Europe yesterday looked a function of end-month portfolio rebalancing (European equities had vastly outperformed) and it is no surprise to now see EUR/USD well above 1.04 on the sharp drop in US yields. Resistance is clearly set at the 1.0480/1.0500 area, above which we could see a spike to the 1.0600/0620 area. That is not our preferred view, but thinning December markets and seasonal dollar weakness mean that such a scenario cannot be ruled out.

Bigger picture, however, weak global demand (note Korea's poor November export data overnight) is not a good story for the pro-cyclical euro. Additionally, colder weather coming to northern Europe is starting to push gas prices higher again and keep the eurozone trade balance under pressure.

We would like to think that 1.05/1.06 is as good as it gets for EUR/USD in December. Elsewhere, look out for Swiss November CPI today. We have been bearish EUR/CHF on the view that the Swiss National Bank wants a stronger nominal Swiss franc to fight inflation. That view will be challenged, of course, should inflation surprise on the downside.

Please also see [Francesco Pesole's article on the Norwegian krone](#). Yesterday, Norway's central bank announced it will trim daily FX purchases from NOK 3.7bn to 1.9bn, which sent NOK rallying across the board. As discussed in the article, we see the two consecutive cuts in FX purchases as an indication of higher appetite for a stronger krone, which would help combat inflation at a time when economic woes and property market fragility may curb the appetite for monetary tightening.

*Chris Turner*

## ⬆ GBP: 1.22/1.23 for cable

The softer dollar environment is giving cable another lift. This rally could extend to the 1.22/23 area unless either today's US core PCE data or tomorrow's US jobs data can put a floor back under US yields.

EUR/GBP continues to hold support near 0.86 and that may well be the case into year-end. Both

the Bank of England (BoE) and the European Central Bank (ECB) should be hiking by 50bp in December. But we are taking the view that risk assets will come under more pressure over coming months – which will lead to renewed – if mild – sterling underperformance.

*Chris Turner*

## ➔ CEE: Hard to be positive on the zloty

Today, we will see PMI numbers across the region. We expect a rebound from lows in Poland from 42.0 to 42.6 and in the Czech Republic from 41.7 to 42.7, following the trend in Germany. On the other hand, in Hungary we forecast a drop below the 50-point level. As [in Poland yesterday](#), the GDP breakdown for the third quarter will be published today in Hungary, which was the only country in the region to surprise negatively in the flash reading (-0.4% quarter-on-quarter) a few weeks ago. Later today, the Czech Republic's state budget result for November will be published. Given the recent increase in the deficit for this year and the question marks over funding, the number will get more attention than usual. However, the start of pre-funding needs for next year through CZGBs switches in recent days indicates a better-than-expected MinFin situation.

On the FX front, two main topics remain on the table in the region: the Polish zloty and the Hungarian forint. Yesterday's [downside inflation surprise](#) pushed down the interest rate differential in Poland by around 25bp, further widening the gap versus the FX spot rate, which is already the largest in the CEE region in our view. So, it is hard to be positive on the zloty, but for now, apart from any rally in the US dollar, we don't see a trigger for a correction. Until then, the zloty is likely to remain below 4.70 EUR/PLN.

Meanwhile, the market seems to be running out of patience in Hungary and the normalisation of relations with the EU is not progressing as fast as expected. Although yesterday's news did not bring anything really new in our view, the forint returned to the 410 EUR/HUF range, which probably cleared the long positioning built up in recent weeks. Thus, in our view, it is still worth waiting for the final decision of the European Council in December and we expect the forint back to stronger levels.

*Frantisek Taborsky*

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