FX Daily: Don't chase the dollar bear trend

At the start of a quiet week for data, the dollar is hovering near recent lows. However, we do not think this is yet the start of the big, cyclical turn lower in the dollar we expect for next year. Instead, falling volatility and firm short-dated US yields can probably see the dollar hold onto current levels. Highlights this week include OPEC+ and key speakers

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USD: Too soon

The DXY dollar index is down around 3.5% from its highs seen in October. The drop looks largely down to the view that the Federal Reserve's tightening cycle is over and that portfolio capital can now be put back to work in bonds, equities, and emerging markets. While acknowledging that November and December are seasonally soft months for the dollar, our view is that this dollar sell-off has come a little early. We are bearish on the dollar through 2024 but expect the core driver to be a bullish steepening of the US Treasury curve – which has not happened yet. Indeed, US two-year Treasury yields remain firm near 5%. We thus urge caution in chasing this dollar decline much further.

In terms of what this week has to offer, we pick out three themes: the Fed, OPEC+ and US data. Fed communication this week will come from the release of the Fed's Beige book and also some key speakers, including Fed Chair Jay Powell, on Friday. Remember that the Beige Book paints a picture of the economy to prepare the FOMC for its meeting on 13 December. It certainly is not clear that the Beige Book will paint a soft enough picture to support the 80bp of fed easing already priced for next year.

In terms of the OPEC+ meeting, our commodities team believe that the Saudis will extend their voluntary supply cut and that the oil market can find some support - a mild dollar positive. In terms of US data, the highlight should be some stable (0.2% MoM) core PCE inflation data for October and the ISM Manufacturing data on Friday. Thursday's US inflation data is probably the largest bearish risk to the dollar this week.

However, with cross-market volatility falling, it seems investors are once again interested in carry trade strategies. We have seen this theme several times this year already, and it is not a dollar negative. It is a negative for the funding currencies like the Japanese yen and the Chinese renminbi. Until we get some clear dovish communication from the Fed or US data is materially weak enough, we think this dollar drop might have come far enough for the time being and suspect that the 103.00/103.50 support area could well hold the DXY this week.

Chris Turner

EUR: Orderly inflation outcome

EUR/USD remains well bid, but should struggle to better resistance at 1.0965/1000 this week. As mentioned above, we think the dollar sell-off may not have legs since the short end of the US rates curve is still pretty firm. From the eurozone side, this week's data highlight will be flash CPI for November set to be released on Thursday. Here, further disinflation is expected in both headline and core readings, bringing year-on-year rates back to 2.7% and 3.9%, respectively. These readings might tend to support the 70bp of the European Central Bank (ECB) easing priced into eurozone money markets next year.

Additionally, expect investors to keep one eye on fiscal developments in Germany. It is unclear from where a political solution will emerge and will do little to discourage views of a stagnant eurozone economy in early 2024. Overall, we favour EUR/USD correcting to the 1.0825/50 area this week.

Chris Turner

GBP: Fiscal divergence

Sterling has been performing a little better of late, no doubt buoyed by the better global risk environment. We do also think that the fiscal story has helped, where the UK government plans to put £20bn to work in the economy, while countries like Germany remain hamstrung by its constitutional court. At the same time, the slightly better November PMI readings have supported sterling too. These developments have left investors looking for just 40-50bp of Bank of England (BoE) easing next year – clearly less than what is expected of the Fed or of the ECB.

The UK data calendar is light this week, but we do have several BoE speakers. Governor Andrew Bailey already seems to be playing around with language on forward guidance, where restrictive monetary policy will be retained for an 'extended period' or, most recently, 'for quite some time'. All in all, we feel that EUR/GBP could correct a little further and a close under 0.8660 could unlock 0.8630 or even 0.8600 this week.

Chris Turner

CEE: Quiet first half of the week

The first half of the week basically has nothing to offer in the region. We will see the first interesting data on Thursday. In Poland, November inflation will be published, where we expect a slight increase from 6.6% to 6.7% YoY, slightly above market expectations. Poland's second estimate of third-quarter GDP will also be released, which will offer a breakdown. We expect a confirmation at 0.4% YoY. On Friday, we will see the same GDP numbers in Hungary and the Czech Republic and also PMI in the region. The Czech Republic will also release budget numbers, and Moody's will publish a rating review of Poland. We don't expect any changes, but it will be interesting to see the assessment of the political and fiscal situation after the elections.

The zloty did not move much last week despite confirmation of an economic recovery. However, the short end of the rate curve is gradually moving up as we expected, which we think should push EUR/PLN down. Of course, the long positioning of the market is good to keep in mind here and will likely be an issue for faster PLN appreciation. These days, we see EUR/PLN below 4.360.

The koruna strengthened last week after a surprise paying flow and maybe some hints of hawkishness from the Czech National Bank (CNB). However, we believe that weak economic data and more mixed CNB views will bring back the rate-cutting discussion and that market rates will go down again. The first signal was already visible on Friday, and rates are thus pointing to a weaker koruna back above 24.450 EUR/CZK.

The forint rebounded last week after the National Bank of Hungary (NBH) meeting but still failed to hold new gains. We think EUR/HUF should go down from these levels, but we need to see new triggers. Last week, we saw positive headlines from the EU money story – and we may see more this week, which would certainly help. Rates also bounced up after the central bank meeting. Overall, we are positive on the HUF and expect levels below 380 EUR/HUF in the coming days.

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