FX Daily: Dovish is the new black

There is a growing (USD-positive) divergence between the Fed – which delivered only a 'timid' dovish pivot – and other major central banks. Yesterday, the Bank of England pushed back against market pricing as it hiked by 75bp, following dovish turns in Norway, Canada and Australia. Today's US payrolls may come in above 200k, adding fuel to the USD rally

Today's US payroll figures may add fuel to the dollar rally

USD: Payrolls can keep Fed away from pivot

The dollar has retained very good momentum in the aftermath of the FOMC announcement on Wednesday, with markets continuing to push their Fed peak rate expectations higher. Fed Funds futures for the March 2023 meeting are currently trading in the 5.10/5.20% region, a clear testament to how markets have not bought into any dovish pivot narrative.

This is particularly relevant for FX given the growing divergence between the Fed and other major central banks. Yesterday, the Bank of England and Norges Bank both surprised on the dovish side, and so did the Bank of Canada and the RBA a few days ago. There's a growing perceived chance that the Fed will be the last major central bank to throw in the towel and arrest its tightening cycle, and we think this notion can provide quite sustainable support to the dollar into the new year.

Today, the focus will shift back to data as US October payrolls are released. Our US economist sees room for a slightly above-consensus headline read (220k vs a conservative 195k), which should overshadow the widely expected 0.1% increase in the unemployment rate and marginal slowdown in wage growth. We expect today's release to leave markets still searching for a higher Fed terminal rate, ultimately keeping the dollar bid. A decisive break above 113.00 in DXY appears on the cards: if not today, probably in the coming days.

Francesco Pesole

EUR: Caught in the crossfire

EUR/USD remains primarily a function of dollar moves, and today's US payrolls release should continue to put pressure on the pair in our view. Having now moved back to the trading ranges seen before the late-October correction (which has proven exceptionally short-lived), we think markets have switched back to a more structurally bearish tone on EUR/USD, and a return to 0.9500 is our base case in the near term.

Domestically, markets will keep an eye on ECB president Christine Lagarde's comments this morning. With the OIS curve currently embedding 60bp of tightening at the ECB December meeting, there is surely room for speculation in either direction on the size of the next hike. From an FX perspective, the implications for the euro have been quite limited, and we doubt this will change drastically in the very near term.

Francesco Pesole

GBP: A very dovish hike

We had highlighted downside risks for sterling as we approached yesterday's Bank of England (BoE) announcement. Our call was for a 50bp dovish surprise, and while the BoE hiked by 75bp, it seemed to tweak the policy message to the dovish side as much as reasonably possible, ultimately triggering a GBP reaction (-1.5% vs USD) quite similar to what we would have seen if it only hiked by 50bp.

As discussed in our BoE review note, the Bank pushed back quite firmly against what markets were previously pricing in terms of tightening (i.e. a 5% peak rate), adding in its forecasts that following the market-implied rate path could cause a three percentage point economic contraction over several quarters and inflation at zero in 2025. The bottom line is that the BoE is essentially shutting the door to another 75bp, and we expect a 50bp hike in December.

The negative reaction in the pound was – in our view – not just due to the dovish repricing in rate expectations, but also a re-connection of FX dynamics with the rather concerning domestic economic outlook, which was flagged quite clearly by the BoE. The fiscal rigour brought by the new UK government may have already had a beneficial effect on the pound, and now the size of the current UK recession may become a primary currency driver. Indeed, the downside risks are still quite significant, and next week's GDP numbers will surely be watched quite closely: consensus is currently around a 0.4% quarter-on-quarter contraction.

Today, BoE chief economist Huw Pill will deliver some remarks, but there are no other key events to monitor in the UK. Risks are skewed towards a re-test of 1.1000 in cable over the next few days, with today's US payrolls possibly adding pressure on the pair.

Francesco Pesole

CEE: Speaking of selloffs...

As expected, the Czech National Bank (CNB) left interest rates unchanged at 7.00% today, in line with surveys and market expectations. In a statement, the phrase "...the CNB will continue to prevent excessive fluctuations of the koruna exchange rate" returned after a hiatus in September. If we are looking for a surprise at this meeting we can find it in the new forecast, which has undergone a significant transformation. Overall, the CNB forecasts slower economic growth, including a recession next year and lower inflation, alongside a massive tightening of monetary conditions. However, despite the big changes in the CNB's forecast, nothing has changed in our view of the main story yesterday. The board considers interest rates high enough and FX interventions are doing their job well with no end in sight for now. Thus, we continue to see the risk of additional rate hikes as low and consider the hiking cycle to be closed, the only one in the CEE region.

On the FX side, the situation remains unchanged. CNB interventions will continue and the line in the sand is clearly drawn at 24.60-70 EUR/CZK. Given the low central bank costs, we do not expect any changes in the CNB's approach anytime soon. This setup coupled with relatively high carry may serve as a good base against the Polish zloty or Hungarian forint, which are much more vulnerable in global emerging market selloffs especially ahead of the upcoming winter.

And speaking of selloffs, the CEE region, surprisingly for us, remains stable despite global conditions deteriorating further. EUR/USD passed another milestone on the way lower again yesterday, the selloff in equity markets clearly indicates a risk-off mood and gas prices also cannot deliver much optimism. Thus, despite the resilience in the region, we continue to believe that the current strong levels are not sustainable. Next week we have a heavy calendar including a National Bank of Poland meeting and CPI prints across the region which we believe can easily serve as a selloff trigger. At the moment, we see room for a move higher in the Polish zloty towards 4.75 EUR/PLN and the Hungarian forint towards 415 EUR/HUF.

Frantisek Taborsky

Authors

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Disclaimer