

FX Daily: Dust settles on a slightly weaker pound

It's been busy in FX markets with surprisingly strong 3Q growth in Europe and an aggressive tax-and-spend budget from the UK Labour government. Eurozone rates and the euro could stay more supported today on the flash Eurozone CPI number, while the US could also see some sticky inflation data. It looks a mixed environment for the dollar, GBP looks fragile



Labour's large tax-and-spend budget is still reverberating across UK asset markets

📉 USD: Dollar takes a back seat to overseas events

The DXY dollar index has softened a little this week – largely in response to overseas events. Here the third-quarter eurozone growth data and October German price data were stronger than expected and have prompted the market to scale back expectations of a 50bp ECB rate cut this December.

And this morning we have just seen USD/JPY drop nearly 1% on Bank of Japan Governor Kazuo Ueda's press conference outlining a plan to continue with rate hikes should the BoJ's forecasts be realised. Most recently the market had felt the BoJ would be less likely to hike on the back of uncertain political developments and potentially a more dovish make-up of the Japanese

government.

That brings us to the dollar. Dollar strength this month has all been about a market positioning for a Donald Trump win and US rate spreads widening in favour of the dollar as the Rest of the World turns more dovish. Well, it seems that the ECB and BoJ may not be quite as dovish as some had feared – news that could potentially cap the dollar's rally for the time being. Given that background, a sticky core PCE deflator today – the Fed's preferred price gauge – at 0.3% month-on-month may not need to send the dollar that much higher.

DXY is currently on support at 104.00 and after one-way bullish traffic for over a month, may be due a modest correction to the 103.65 area.

Chris Turner

⬆️ EUR: 50bp from the ECB in December is not a done deal after all

Yesterday was a day for the ECB hawks. German and [eurozone data surprised on the upside](#) as did German October CPI. And the influential Isabel Schnabel said the ECB should not rush further rate cuts. This prompted around a 12bp repricing higher in the terminal rate for the ECB's easing cycle and finally saw the two-year EUR:USD swap rate differential narrow, supporting EUR/USD. The same dynamic could be present in the European morning should the eurozone October flash CPI surprise on the upside and again pare back expectations for the ECB rate cut in December. These still stand at 34bp.

EUR/USD could retest yesterday's 1.0870 high on today's European data – but a move up to 1.09030 might be a bridge too far given the pivotal US elections next Tuesday.

Chris Turner

⬇️ GBP: Sterling a little weaker as the dust settles on the budget

Labour's large tax-and-spend budget – described by some as an "old Labour" policy – is still reverberating across UK asset markets. Sterling briefly got a lift yesterday on the view that the budget was stimulative and that the Bank of England easing cycle would need to be repriced higher. However, as our UK economist James Smith concluded in his [budget review piece](#), we suspect the BoE is unlikely to be swayed by the government's budget plans and we see the risk that yesterday's spike in short-dated sterling interest rates gets reversed.

At the same time, it looks as though Labour is sailing very close to the wind with its borrowing plans – with new Gilt supply coming dangerously close to £300bn for FY24/25 and FY25/26. EUR/GBP should be trading a little lower based on short-dated rate spreads and the reason it is not is probably because a modest fiscal risk premium is going back into sterling. Should eurozone CPI surprise on the upside today, EUR/GBP could move closer to 0.8400.

Over the medium term, we are slightly bullish on EUR/GBP because of the market under-pricing the forthcoming easing BoE cycle. And it now seems the UK budget may add to that trend if indeed a modest fiscal risk premium gets priced into the pound.

Chris Turner

📌 CEE: Region remains under pressure

Yesterday's GDP data for the third quarter disappointed, especially in Hungary, confirming a return to technical recession, but the data in the Czech Republic was also slightly weaker, below central bank expectations. Inflation numbers in Poland for October will be published today, the first in the CEE region. Our economists expect a slight pick-up from 4.9% to 5.1% YoY, one-tenth above market expectations. However, core inflation in particular surprised to the upside in September and may get more attention this time.

CEE currencies remain under pressure and we maintain a bearish view going forward. EUR/HUF moved to new highs and traded above 408 for a while yesterday. Weak GDP data did not help the situation and the rates market remains mixed. On the one hand, valuations show significant cheapness of HUF assets, on the other hand, the market is risk-off ahead of the US elections and not much willingness to take too much risk ahead of the risk event. Thus, we do not see much reason for improvement and approaching 410 EUR/HUF seems to be the next test, which could be an uncomfortable level for the central bank.

In Poland, it was only at the end of yesterday's trading that the POLGBs market reflected the surprisingly high deficit increase announced a day earlier and today we could see further reverberations of market fears of higher bond supply, exposing PLN as well. In the Czech Republic, the CNB blackout period starts later today and so far we haven't heard much. That means today is the last chance to see any headlines, but the 25bp November cut seems like a done deal.

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