

FX Daily: Easing into year-end

FX volatility remains subdued as financial markets lick their wounds ahead of year-end. This week's data calendar is relatively light in the G10 space, with a focus on the Bank of Japan (BoJ) meeting, US housing data and confidence readings on both sides of the Atlantic. We'll also see central bank meetings in Hungary and the Czech Republic, too



➔ USD: Risk rolls over

Looking across asset markets the investor mood seems to be leaning towards a 2023 slowdown. Bond markets remain bid, while both equity and commodity markets are rolling lower after a decent rally in October and November. Investors will continue to focus on China as a potential engine of growth in 2023, but for the time being, we have yet to see any material outperformance of the Chinese renminbi or local equity markets. This suggests that the risk of a disorderly exit from zero-Covid policies for the time being trumps the reopening story and perhaps Beijing's re-orientation to growth policies.

That leaves the market to focus on the tight(er) monetary policy being implemented around the world. Last week's hawkish shift from the European Central Bank has dented eurozone and global growth prospects for 2023 and leaves the dollar in a rather mixed position. On the one hand, the

ECB wants tighter monetary conditions - including a stronger euro. On the other, the Federal Reserve is not done with its tightening cycle and a global slowdown typically is not a good story for a pro-cyclical currency like the euro.

Events this week look unlikely to break new ground on this story. In the US, we will see a variety of housing data (all expected to be soft), some consumer confidence data and on Friday the PCE personal income, spending and price data. The November core PCE deflator is expected at a subdued 0.2% month-on-month - in line with the softer CPI prints of October and November. None of this looks likely to provide much support to US bond yields, where the 10-year Treasury is hanging onto the 3.50% area by its fingernails. This all tends to suggest that DXY risks sinking back to the 104.00/104.10 area this week.

Chris Turner

➔ EUR: Expect comparisons to 2007

Last week's hawkish tilt from the ECB will invariably draw comparisons to the 2007 period, where EUR/USD enjoyed a strong rally. The Fed had concluded its tightening cycle at 5.25% in the summer of 2006 and the ECB was playing catch-up - a catch-up which resulted in former ECB President Jean-Claude Trichet's final and ill-fated rate hike to 3.25% in July 2008. Coincidentally, expectations now are that the ECB will also be taking the policy rate to 3.25% next summer. The difference this time is that global growth is much weaker now than in 2007 (5-6%) and we suspect high energy prices will continue eating into the eurozone's external position.

On the agenda today is the Germany Ifo business confidence index for December. Last week's release of the German PMI data showed a modest pick-up in business confidence - albeit still in recessionary territory. Today's Ifo data is expected to see the expectations component bounce up to 82 from 80 - still very low. Any upside surprise could give EUR/USD a modest boost in thin markets.

We doubt EUR/USD will break new ground this week, although it is hard to rule out a move back up the 1.0700 area.

Chris Turner

➔ CEE: Last NBH and CNB meetings of the year

The CEE region will remain interesting until the last moment of the year. On Tuesday, the Hungarian National Bank (NBH) will hold its last [meeting](#). The NBH has made it clear on several occasions that the temporary and targeted measures, introduced in mid-October, will remain in place until there is a material and permanent improvement in general risk sentiment. Although we've seen some progress here, we don't think enough has changed to trigger an adjustment in the monetary policy's hawkish "whatever it takes" setup. Nevertheless, Hungary will also be in the spotlight because of other milestones in the EU story. The European Council approved Hungary's recovery plan and suspended cohesion funds for 2021-2027 under the rule of law mechanism. The next step should be the signing of a partnership agreement between Hungary and the EC on the absorption of the cohesion funds. However, it is not clear how and when this will take place.

The Czech National Bank (CNB) will hold its last meeting of the year on Wednesday. We expect it to be a non-event, with rates and FX regimes unchanged. The new forecast will not be released until

February. Board members have been very open in recent days and hence there is minimal room for any surprises. The traditional dovish majority has publicly declared that interest rates are high enough and continue to choose the "wait and see" path. The governor also confirmed this week that the central bank will continue to defend the koruna. At the same time, another board member confirmed that the CNB has not been active in the market for some time. So it is hard to look for anything new here either.

In the FX market, as we mentioned last week, we believe that the global story has little positive to offer to the region this year. On the other hand, the deterioration in equity market sentiment late last week should have a delayed impact on CEE FX this week. Moreover, domestic rates with the exception of Hungary cannot support FX, so we should see some correction of previous gains in the region this week. We do not think central bank meetings will impact FX much and so the main story will be the Fed and ECB effect from last week. We see the Czech koruna as the most vulnerable as it hit new lows against the euro on Friday. A correction back to 24.250 EUR/CZK should thus not be a problem. On the other hand, we think the Hungarian forint can still benefit from the progress in the EU story for a while and get below 405 EUR/HUF. The Polish zloty remains trapped in the 4.680-700 EUR/PLN band, and we see it rather on the upper side for this week.

Frantisek Taborsky

GBP: Sterling will be the main victim of euro strength

The ECB would clearly like a stronger euro to help out with its battle against inflation and it was telling at last week's ECB press conference that President Christine Lagarde was keen to highlight that the ECB would be tightening longer than the Fed. If the ECB is to be successful in getting the euro higher, then the euro will need to rally against those currencies with major weights in the trade-weighted euro index. The biggest weights in this index are the US dollar (16%), the Chinese renminbi (14%) and then the British pound (12%).

Of the three, we would say that sterling is the most vulnerable given that the Bank of England (BoE) is closer to ending its tightening cycle than the Fed and that the UK's large current account deficit leaves sterling vulnerable in a global slowdown. We suspect EUR/GBP finds good demand under 0.87 now and we remain happy with a 0.89 target for 1Q23.

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