FX Daily: Echoes of September, but USD rally less likely now

We expect a 25bp Fed cut today, in line with pricing and consensus. In September, a similar setting from a pricing perspective prompted a sharp dollar rebound. Now, with positioning more balanced and inflation looking better, it's harder to see the same reaction. We expect some CAD weakness as the Bank of Canada should also cut by 25bp today

Markets are expecting a Fed rate cut from Jerome Powell later today

USD: Some upside risks, but nothing like September

When the Fed delivered a well-telegraphed 25bp cut in September, the dollar rallied. Back then, USD positioning was heavily short, and some hawkishly perceived comments by Powell exacerbated the correction. From a pricing perspective, today's FOMC setup looks similar: markets have expected a 25bp cut for over a month, consensus is unanimous (we also expect a 25bp cut), and a December follow-up reduction is nearly fully priced in. The ingredients for another 'buy the rumour, sell the fact' dollar rally are all there.

However, dollar positioning is markedly different this time. CFTC data is unavailable due to the shutdown, but options markets suggest a much more balanced picture. Excluding the brief spike in early October (linked to French and Japanese political risk), the 3-month DXY-weighted 25-delta risk reversals are at the highest since April and close to zero.

Incidentally, last week's benign US CPI print gives Powell little reason to sound more hawkish. And despite the lack of official jobs data, ADP (which will now release payrolls weekly) and the Fed's Beige Book point to further labour market deterioration. So, while risks are slightly tilted to the upside for USD today, any rally should be smaller and shorter-lived than in September. The likely announcement of the end of QT could also limit USD upside.

Francesco Pesole

EUR: Soft momentum

EUR/USD lost some ground overnight and is lagging other G10 currencies this week. Markets are instead favouring a rotation to China proxies AUD and NZD (the former also helped by hot inflation overnight), and the yen, which benefited from some verbal intervention. It appears to us as another signal that markets are becoming more focused on domestic events and relative value in FX: clearly, some good activity surveys out of Germany in the past few days (PMIs and Ifo) aren't enough to prop up the euro.

The consensus view is that tomorrow's ECB meeting will be a non-event: here's why we agree. The implications for EUR/USD are likely to be limited, and today's FOMC should be the only input – if anything – for direction in the pair.

As discussed in the USD section above, we see some modest upside risks for the USD. That may not be enough to take EUR/USD sustainably below 1.160, though, and the short-term outlook for the pair remains neutral in our view – at least until US jobs data is published.

Francesco Pesole

CAD: BoC to cut 25bp today

We expect the Bank of Canada to cut rates by 25bp today (full preview here). Markets have converged to this view, and the CAD OIS curve now prices in 21bp, as ongoing trade-related risks to activity and jobs – even higher after last week's US-Canada escalation – are outweighing some stronger-than-expected employment and inflation figures for September.

We see downside risks for CAD today. Markets are largely pricing in a cut, but it will be hard for the BoC to shut the door to more easing given the worsening trade picture. There are some expectations in the CAD curve for more cuts, but rather diluted over the next 6 months and for 15bp in total. The real policy rate in Canada is well above the last time unemployment was at the current 7.1%, and the extraordinary downside risks to the economy probably justify at least one more cut. That might come earlier than expected, with January potentially becoming a target for easing speculation: currently, it's embedding 35bp of easing in total.

The loonie has been resilient to negative trade news, partly as it was already trading at a discount relative to short-term fair value. Any dovish repricing in the CAD curve shifts that CAD fair value lower (higher in USD/CAD), and can allow further build-up of CAD shorts, even if that is a rather crowded trade. As we see USD resilience as temporary, we still expect USD/CAD to end the year at 1.38. In the near term, the balance of risks is tilted to 1.41 in our view.

Francesco Pesole

CEE: Long positioning leaves currencies vulnerable to surprises

The region remains in hibernation, awaiting the ECB and Fed and more data in the second half of the week. However, yesterday we saw a decent dovish headwind in the PLN and HUF rates market, while the CZK market was closed for holidays, and today should catch up with this move. Although FX was more or less stable yesterday, we believe that the drop in rates can somehow offset the support from higher EUR/USD and global risk-on mood in the coming days.

Although the ECB and Fed should not be big game changers, they will still be the main drivers for CEE FX this week. Positioning remains significantly on the long side, especially in the case of HUF and to some extent PLN as well, making both currencies sensitive to any surprises on the global side if we find a stronger US dollar again in the coming days, although this is not our baseline.

In this context, attention should also be paid to Thursday's GDP figures in Hungary, where our estimate is significantly below market expectations, which could once again renew some market bets on NBH rate cuts, and undermine HUF strength after reaching the current lows of 388 EUR/HUF.

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