

FX Daily: Egyptian pound finally succumbs to 2022 pressures

Away from G10 markets, the Egyptian pound finally sold off 17% yesterday as local policymakers had to implement a flexible exchange regime to secure IMF funding. Attention will turn to countries in similar predicaments. For today, the highlight will probably be US price data, including the 3Q employment cost index release. Dollar to remain bid on dips



The decline in the Egyptian pound is not unexpected as the country has suffered from higher global interest rates

USD: 3Q22 employment cost data will be important

In a busy day for FX yesterday, one could be forgiven for missing that Egypt had devalued its pound – or more correctly, had allowed it to float. Stepping back from managing its exchange rate had been a pre-condition the International Monetary Fund (IMF) had outlined to Egyptian authorities in return for a 46-month, \$3bn loan. The decline in the pound was not unexpected as Egypt suffered from both this year's food inflation shock and higher global interest rates. As my colleague James Wilson highlighted in his emerging market (EM) overview: ['Back to the 80s: What soaring inflation, US rate hikes, and a stronger dollar mean for EM debt'](#), Egypt screened poorly for government interest expenses as a percent of GDP – not far behind Sri Lanka which had already defaulted on its debt earlier this year.

The question then turns to which country might be in a similar predicament to Egypt. Egypt's sovereign credit default swap (CDS) had been trading above 1000bp ahead of yesterday's move. There are ten other EM sovereigns with CDS above 1000bp. Many are in Africa and in Central America. Perhaps the most in focus now could be Nigeria's naira (NGN). Here Nigeria also has a relatively high government interest cost relative to GDP (30%) and its CDS trades at 1070bp – very close to Egypt. Local authorities in Nigeria have managed \$/NGN closely over recent years, but have recently allowed the naira to depreciate 5% since the summer. 3m implied yields through the FX forward are trading at 37%, with pressure building for a \$/NGN move to 500 into next spring.

Back to today in G10, the hot story will be US price data. We get to see the 3Q22 Employment Cost Index (ECI). This is an influential number for the Fed and its spike to 1.4% quarter-on-quarter in the first quarter certainly contributed to this year's hawkish Fed. Consensus expects the 3Q ECI to soften to the 1.2% QoQ area in today's release. Any upside surprise could push the pricing of the Fed terminal rate (now 4.75% and off a recent high at 5.00%) higher. This would be dollar positive. Maybe 110 does prove support for DXY after all.

A final few points for the strong dollar story: i) the Bank of Japan kept policy unchanged and has CPI forecasts for FY23 and FY24 down at 1.6%, justifying dovish policy and a weak Japanese yen ii) Brazil has contentious presidential elections on Sunday, \$/BRL could be a lot higher Monday morning and iii) the latest [BIS triennial FX survey](#) shows the dollar retaining its dominant status in global FX transactions.

Chris Turner

➡ EUR: A dovish 75bp hike?

[The ECB hiked rates by 75bp yesterday](#), but in some ways, it could have been described as a dovish hike. Certainly, interest rate markets took note of the reference to '[substantial progress being made in withdrawing monetary accommodation](#)' and took 30bp off the pricing of the terminal ECB rate, which is now priced at 2.50%. We still think that it is too high. The repricing of the ECB cycle saw euro two-year swap rates fall and the spread to two-year dollar rates (normally a key driver of EUR/USD) widen back out to 200bp in favour of the dollar. That is the widest since mid-August. We had said going into the meeting that interest rate differentials had not been playing a big role in EUR/USD pricing, although that could reverse into December as speculation of an ECB pivot grows.

For today, EUR/USD might bounce around a little as ECB hawks brief the media that the central bank's statement was not quite as dovish as the market has interpreted. But we think the dollar should stay supported into next week's FOMC meeting and would favour EUR/USD edging down today to the 0.9910/20 area – marking the top of a bear trend channel which was recently broken.

Chris Turner

➡ GBP: Taking stock ahead of next week's BoE meeting

Sterling will be settling into ranges ahead of next week's event risks in the form of both the Fed and Bank of England (BoE) rate meetings. Intriguingly, the pricing for next week's BoE rate meeting is starting to drift below a 75bp hike to 3.00%. Remember that at the height of the fiscal fiasco, the market had briefly priced the bank rate being taken to 3.90% at next week's meeting.

We think the chances of a 50bp hike from the BoE are greater than the market currently prices

– and that is a sterling negative. Let's see whether GBP/USD can break back under 1.1500 today, while the softer euro probably defines the EUR/GBP range somewhere in the 0.8600-0.8700 region.

Chris Turner

➔ CEE: ECB provides a mixed outcome for the region

The regional calendar is almost empty again and today we will see only PPI data from Hungary. The Central and Eastern Europe region continues to follow global events and the ECB yesterday injected new impetus into this. On the one hand, the fall in the EUR curve means higher interest rate differentials across the region. In Poland and the Czech Republic, this led to new highs in differentials, supporting local FX on its way to stronger levels. On the other hand, EUR/USD back below parity is clearly negative news for the CEE region and we are likely to see a negative reaction to it today. Moreover, gas prices have moved back above EUR 100/MWh, probably in response to the EU's indecision on how to proceed with price cap measures. Thus, overall we are likely to see a halt to the CEE FX rally of the last two weeks and adopt a wait-and-see mode before a heavy calendar next week.

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