FX Daily: Euro area PMIs to set the tone

The calendar is packed for this last full trading week of the year. Central bank rate meetings in the US and Japan take centre stage, but we'll also see rate meetings in the UK, Sweden, Norway, the Czech Republic, and Hungary. Starting the week will be the December flash PMIs in Europe – the main question being whether or not they have deteriorated further

Today's euro area PMIs will set the tone for European currencies this week

USD: Dollar holds gains

It's Fed week, and the central bank is expected to cut its target policy band by 25bp to 4.25-4.50% on Wednesday. That is fully priced, and as our US economist James Knightley here, more interest will be had in how the Federal Reserve prepares to explain skipping its meeting in January. New Fed forecasts should also reduce the number of expected rate cuts in 2025 to three from four. This is all currently priced by the market, but there seems little reason for the Fed to dovishly surprise this week and we see the dollar staying supported.

Additionally, tomorrow's release of November retail sales is expected to show healthy 0.4% month-on-month growth in the retail sales control group – suggesting US consumer habits are alive and well.

But as seen in previous weeks, the dollar could also get dragged around by events overseas, where pressure looks likely to stay on the Chinese renminbi, and we should expect more rate cuts in Europe and elsewhere.

As a side note, we see the occasional references to the risk of another 1985 Plaza Accord to weaken the dollar. We take the view that 2025 will be more akin to 1983-1984, when more air was pumped into the dollar bubble.

DXY should again find support near 106.50/70 and should push back above 107.00 should eurozone PMIs disappoint today.

Chris Turner

EUR: Enough bad news in the PMIs already?

The highlight of today's session will be the release of the French (09:15am CET), German (09:30am) and eurozone (10:00am) December flash PMIs. November readings were not quite as bad as feared, although all three composite readings remain in contractionary territory.

Partly responsible for that pessimism is local politics, where today sees German Chancellor Olaf Scholz's government facing a no confidence vote. This should lead to early elections in February. Already, both major political parties – the Social Democratic Party (SPD) and the Christian Democratic Union (CDU) – seem to moving towards some kind of fiscal stimulus. This could prove an upside risk for the euro in the second half of 2025. However, before then EUR/USD will have to deal with US fiscal stimulus and a potential trade war.

Also today we have a variety of European Central Bank speakers. Of these we would highlight ECB President Christine Lagarde (09:30am CET), Pierre Wunsch (1:00pm) and Isabel Schnabel (5:30pm). The latter two come more from the hawkish side and there could be upside risks to EUR/USD if they push back against expectations for sub-neutral monetary policy rates. Additionally, the hawks seem to have a new script in arguing that it is not the ECB's job alone to restore growth.

EUR/USD is hovering not far from 1.0500 and faces some downside risk today from the PMI numbers. Expect it to trade well within a 1.0450-1.0550 range today.

EUR/GBP enjoyed a sharp bounce on Friday, helped by the weaker-than-expected October UK GDP number. We have some PMI numbers in the UK today, but the main event this week is the November CPI (Wednesday) and the Bank of England meeting (Thursday). Services CPI is expected to remain sticky above 5% year-on-year, meaning that the BoE is likely to retain its gradual approach to policy easing. We suspect this EUR/GBP rally stalls near 0.8350 and favour a move back to 0.8250.

Chris Turner

JPY: Less than 20% of a BoJ rate hike on Thursday

After a raft of source-based stories over the last two weeks, the market now attaches a less than 20% probability to a 25bp Bank of Japan hike this Thursday. Our team thinks the chances are higher. However, helping to swing the BoJ's decision may be the level of USD/JPY. This has crept up to 154 recently, helped by both these source stories plus the sell-off in the US Treasury market.

While our medium-term valuation models show the yen as the most undervalued currency in the G10 space, our baseline forecasts do, however, show USD/JPY moving steadily higher through 2025 as US Treasury yields rise. The yen will remain the hedge against the inevitable periods of risk asset corrections in 2025, but barring surprise US macro weakness, 2025 should be bullish for USD/JPY.

For this week, we think USD/JPY looks biased to the 155 area ahead of Thursday's BoJ rate meeting.

Chris Turner

CEE: Central banks remain the main driver of FX

After last week's inflation numbers, the focus in the CEE region shifts to the last central bank meetings of the year.

The Czech Republic's PPI numbers will be released today, the last data point before the Czech National Bank meeting on Thursday. In Poland, we will see core inflation for November, after the final numbers on Friday brought a 0.1ppt upward revision to the 4.7% YoY rate. Core inflation should stagnate at 4.1%, according to our estimate.

Tomorrow, we expect the National Bank of Hungary to leave rates unchanged at 6.50%. The main focus remains on FX, which has seen some relief in the last few days, but we think it's still too early for the NBH to return to rate cuts.

The Czech National Bank will also decide on rates on Thursday. In line with expectations and market pricing, we expect the first pause in the cutting cycle at 4.00%. So the question for this meeting is what conditions the central bank wants to see to return to rate cuts next year.

Thursday and Friday in Poland will see the release of wages, industrial and retail sales data. And on Friday in Turkey, inflation expectations will also be released – the last key numbers before the December Central Bank of Turkey meeting next week, when we expect the cutting cycle to begin.

We also have some speakers scheduled in Hungary. Today, incoming NBH Governor Mihaly Varga will have a hearing in parliament where we could gain insight into his views on monetary policy. On Friday, Hungary will be debating the state budget for next year.

The FX market has fully disconnected from the global story and continues to ignore the lower EUR/USD. Interest rate differentials remain the main driver and we do not expect any changes before the end of the year.

The ECB has triggered some hawkish repricing in the region, supporting the current strong PLN and CZK levels. Central banks will again be decisive this week. While the hawkish views of the National Bank of Poland's governor on Friday will support PLN this week, CZK is more of a vote-split issue on Thursday. Given current EUR/CZK levels and rate pricing, we see the odds as more negative for the CZK if someone on the board votes for a rate cut. Stable NBH rates should further support a HUF recovery in our view.

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