FX Daily: EUR/USD bears survive the ECB test

The dollar is largely holding onto gains as this week's US inflation data has come in on the firm side and kept USD rates supported. EUR/USD bears have also survived the ECB test, where Christine Lagarde has not proved as dovish as some might have expected. The calendar is quiet today and again we see little reason to leave long dollar positions

USD: Dollar ends the week on a firm footing

It has been a busy week for the events calendar but the dollar is ending the week towards the top end of its range. US inflation data this week has come in towards the firmer side of expectations, although it does now look like next week's release of the core CPI deflator will come in at a reasonable 0.2% month-on-month. In all, there has not been much re-pricing of the Federal Reserve cycle this week and in reality, we doubt next week's FOMC meeting will have a major impact on the dollar either.

We can say 'so far, so good' for dollar bulls like ourselves, where December seasonal weakness has so far not touched the dollar. We do not have too much to add here beyond what we present in this month's FX Talking and we cannot rule out DXY pushing through resistance at 107.00 to 107.50 in quiet markets.

Chris Turner

EUR: Position adjustment

EUR/USD was largely unchanged on yesterday's European Central Bank event risk despite President Christine Lagarde not sounding extremely dovish, with a slightly weaker euro only at the end of the trading session. Yet as Carsten Brzeski writes, the direction of travel is lower for eurozone rates and rates will not necessarily be stopping at neutral (2.00/.2.25%). Some might note the sell-off in eurozone bond markets and especially the widening of the Italian:German sovereign spread. Yet this spread had been exceptionally tight and the widening looks profit taking/position adjustment rather than any view that the ECB is blind to the looming eurozone slowdown.

EUR/USD largely remains glued to 1.05 and we doubt it needs to stray too far from that level today. Next Wednesday's FOMC meeting is probably the next big test of the dollar now and we very much doubt those short EUR/USD will need to cut what is a carry-positive position. 1.0450-1.0550 may prove the extremes of the short-term range.

Elsewhere, the Swiss National Bank did go for the more aggressive 50bp rate cut option. New SNB President, Martin Schlegel, was honest in saying the SNB does not like negative rates but is prepared to use them if necessary. We are not yet fully subscribed to the SNB negative rate story next year but in any case maintain the position that the SNB will not be able to cut as deeply as the ECB and that EUR/CHF will trend lower.

Chris Turner

CZK: December pause seems like done deal but February remains open

The Czech National Bank blackout period has begun and we shouldn't see any more headlines from the board until next Thursday's meeting. Although inflation in November was slightly below the CNB's forecast, its upward trend seems reason enough for central bankers to wait for a peak in December and decide again in February with better knowledge of January's repricing. Czech inflation traditionally sees its highest seasonality in January, which sets the level for the whole year. A December pause in the cutting cycle seems like a done deal despite EUR/CZK being almost 1% lower than the CNB forecast in November.

So the ultimate question is what level of headline inflation the board wants to see in January for the resumption of the cutting cycle at the February meeting. Our economists see 2.7-2.8% for January, which is probably similar to the CNB forecast. That said, several board members have mentioned that there is still room to cut rates, but they want to see the February forecast and the January inflation print. Our economists' baseline forecast is to pause even in February at this point. However, market pricing has moved to the very hawkish side with only 10bp priced in for both the December and February meetings combined. Although next week's meeting is likely to bring a hawkish tone, supporting further CZK appreciation, the risk in general becomes the opposite scenario, i.e. a rate cut in February, which the market will be watching.

Frantisek Taborsky

CEE: Rather muted impact from ECB

Only secondary data will be seen at the end of the week. This morning we could see industrial production in Romania for October, showing a small year-on-year decline of 0.9%. Later today we will see the final inflation numbers in Poland, which should confirm the 4.6% YoY rate posted earlier. Also across the region, the current account numbers for October will be released, which in the Czech Republic and Poland in particular have delivered some surprises in previous months. The market may be watching to see if these were one-offs or a new trend, impacting FX.

Otherwise, the end of the week should be rather quiet, and process the impact of yesterday's ECB meeting. Some upward repricing in EUR rates triggered a similar effect in the Polish zloty and Czech koruna markets, resulting in essentially unchanged rate differentials. At the same time, a slightly lower EUR/USD should have a negative impact on FX. On the other hand, PLN and CZK have been rather disconnected from the global story recently and following more of a rate differential, which would imply a rather muted impact on FX unless we see more repricing in rates today.

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