FX Daily: Falling oil prices can hold the dollar back today

The dollar has started the week on the front foot, helped by some disappointment on Chinese stimulus and further hawkish repricing in Fed expectations. However, declining oil prices suggest the scope for further USD gains today is tight. Inflation data in Canada and New Zealand may support local currencies given stretched dovish expectations

We have published our monthly update of FX views and forecasts - [FX Talking: Groundhog Day for the dollar?]

USD: Rally looking a bit stretched

The dollar and oil went opposite ways yesterday. The greenback was strong across the board, shrugging off the drop in crude triggered by some media reports that Israel does not plan to hit Iran's oil and nuclear facilities. That is probably the result of some disappointment among investors about the details of China's stimulus measures announced on Saturday.

As US markets reopen today after a long weekend, the dollar might reconnect with the softer oil story. Incidentally, the rates picture can hardly turn much more supportive than this for USD given markets are now pricing in only 44bp of Fed easing by year-end, and data has not improved enough to lead markets to push that pricing to just 25bp. Should we see more independent dollar outperformance, we could conclude that is due to some positioning ahead of the US election in three weeks from now. Asset markets seem to be pricing in a win by Kamala Harris, which is seen as the least disruptive outcome, and given how close the candidates are in the swing States polls, some defensive positioning can see dollar inflows into the vote.

On the data side, things are quite quiet in the US. The Empire manufacturing index is the only noteworthy release today, and markets will probably be more interested to hear from FOMC member Mary Daly, who is a neutral figure in the committee and may offer a good sense of where the consensus sits after the higher-than-expected jobs and inflation numbers. Yesterday, another relatively neutral member – Chris Waller – said that more caution is warranted on rate cuts, which contributed to dollar strength.

Francesco Pesole

EUR: Testing the lows

The euro is losing some ground ahead of Thursday's European Central Bank meeting and has now made a decisive break below 1.090. The rewidening in rate differentials with the USD is clearly prompting a shift in strategic EUR/USD positioning, and CFTC data showed net-longs have declined from 13.5% to 5.9% of open interest since early September.

A more balanced positioning picture means EUR/USD can find some support in the dips. Incidentally, our models return a short-term fair value of around 1.093. As discussed above, the dollar might reconnect with lower oil and EUR/USD may edge back higher. Moving on, unless the ECB surprises with a hold or out-of-consensus guidance on Thursday, the direction for the pair will be set by US events in the next month or so.

In the UK, jobs figures released this morning did not send any unidirectional message to the Bank of England. Unemployment ticked lower, but that is not a highly reliable indicator, while wage growth excluding bonuses slowed as expected. It's worth noting that the majority of sectors now have vacancy rates below pre-Covid averages when wage growth was around 3.5%, well below the current 5%. Our UK economist believes there is room for a further adjustment lower in wage growth that will ultimately allow the BoE to cut with more confidence. Tomorrow's UK CPI is the biggest event for sterling markets, and we see risks to the upside for EUR/GBP, which may retest the 0.8400 level.

Francesco Pesole

CAD: Dovish rate expectations to be challenged

Last week's Canadian jobs numbers came in quite strong. Employment rose 47k, almost twice the consensus figure, and unemployment surprisingly dropped back to 6.5%. On the same day, the Bank of Canada released its Business Outlook, which showed a further easing in inflation expectations, but also a rebound in business optimism and expectations for future sales.

The latest data, paired with the hawkish repricing in Fed expectations, should be enough to discourage bets on a 50bp cut by the BoC this year, in our view. However, markets continue to price in 71bp of BoC easing over the next two meetings, with 37bp for next week's rate announcement. Canadian inflation is released today, but we doubt that will be a game changer for BoC rate expectations. Headline CPI is seen as having dropped below 2.0% in September, but core measures may have stalled. That should continue to point to rate cuts, but the improved jobs picture does not justify 50bp reductions. We expect CAD to outperform in the crosses thanks to some BoC hawkish repricing. USD/CAD may struggle to break decisively lower, but a retightening of rate differentials should allow at least a halt in the rally, and perhaps a correction back to 1.37 in the near term.

Another commodity currency – the Kiwi dollar - will face a CPI test today. The Reserve Bank of New Zealand cut by 50bp this month on the view that inflation has decisively turned lower while growth concerns are building. That is also the basis for markets high conviction call on another half-point reduction in December. While headline CPI should move back close to the 2.0% target range mid-point, we see risks that non-tradeable inflation ends up coming in hotter than the RBNZ hopes. Ultimately, NZD may also get some help from inflation today, as markets may no longer be certain about a 50bp December move. NZD/USD remains vulnerable to some Trump hedges ahead of the election, but an improved rate profile can help the Kiwi dollar find buyers in the 0.6000-0.6050 region.

Francesco Pesole

CEE: CZK prospects are improving despite negative sentiment

Today's calendar offers final inflation in Poland and September budget numbers for Poland and Turkey. We expect inflation to be confirmed today, rising from 4.3% to 4.9% year-on-year, currently the highest figure in the CEE region. Tomorrow, we should also see core inflation numbers rise from 3.7% to 4.3% in our estimate. Budget numbers in Poland could garner some market attention given that this year's revisions are expected to be impacted by flood-related costs as well as weaker tax collections.

FX markets in the region were muted yesterday due to weaker activity in global markets given the US holidays. The Czech koruna received a boost after surprisingly strong current account data yesterday. We remain constructive on the slow Polish zloty and CZK gains within the region, although again, a lower EUR/USD does not suggest the possibility of a stronger rally here. On the other hand, local rates remain to be paid across the board, improving the outlook for all CEE FX including Hungary's forint, which is underperforming peers for now. Given the better economic data and surprisingly strong current account, the CZK seems like the right place to be in the region for now. The market was negative on the CZK until recently, which would suggest some short positioning while higher inflation could trigger some hawkish central bank comments ahead of the November CNB meeting. In the medium term, we see EUR/CZK returning to 25.00 and lower later. Short-term global conditions may be a problem for this path, but the rate differential is already pointing to these levels.

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