FX Daily: Geopolitical overload

FX markets face much geopolitical influence this week. Beyond the IMF meetings in Washington, where many G10 central bankers speak, we also have a BRICS summit in Russia. Middle East tension continues to grow, and we are now nearly two weeks away from the US election, where markets seem to be positioning for a Trump victory. Expect the dollar to stay bid

This week's International Monetary Fund (IMF) meetings in Washington are just one of many items currently on the FX market's radar

USD: Beige Book is probably the biggest threat to the dollar

FX markets seem to be positioning for a Trump victory in next month's US presidential election. October seems to have been a good month for Donald Trump in opinion polls and the dollar is bid across the board. Interestingly in the week to last Tuesday (15th) speculators and in particular asset managers bought the dollar heavily against the euro, but also against the Canadian dollar. As we discussed in our FX scenario analysis for the US election, we felt that Canadian dollar and Mexican peso would not have as easy a ride as they did back in 2018/19 if Trump was re-relected.

It is with US elections looming large that FX markets this week face the challenge of geopolitics. The IMF meetings in Washington are more a forum for central bankers to share their latest views (and many central bank governors will be speaking), but we also have Russia hosting a BRICS summit and no end in sight for Middle East tension. Geopolitics in the driving seat is evidenced by gold pushing above $2700/oz even though the dollar is rallying broadly.

It is hard to see this dynamic changing substantially over the next couple of weeks. Notably, Fed Chair Jerome Powell does not seem to be speaking this week, probably because of the imminent elections – but on Wednesday, the Federal Reserve does release its Beige Book report ahead of the next FOMC meeting on 7 November. Many believe the soft showing of the prior Beige Book release prompted the FOMC to start with a 50bp cut in September. This release is probably seen as the biggest threat to the dollar this week. Yet, US consumption and the labour market have held up recently, and there is no guarantee that this week's Beige Book release will push interest rate markets into pricing 50bp of Fed easing this year compared to current pricing of just 43bp.

The dollar has come quite a long way in a short space of time. But unless the Beige Book surprises on the downside or Thursday's European PMIs (see below) miraculously surprise on the upside, it seems that DXY will probably stay bid in the top end of a 103-104 range.

Chris Turner

EUR: Licking its wounds after a tough week

EUR/USD is licking its wounds after a tough week. Two key drivers have been: a) the market's repricing of a potential Trump victory presaging a potentially tariff-inflicted period for world trade, and b) European Central Bank President Christine Lagarde throwing more fuel on the dovish bonfire with her press conference last Thursday. With two-year EUR:USD swap differentials now very wide at 141bp and weighing on EUR/USD, there will be much focus on the ECB speakers in Washington this week. Here, we'd pick out Lagrade speaking to Bloomberg TV tomorrow and Chief Economist Philip Lane speaking on Wednesday.

Thursday's release of PMIs across the Eurozone region will also be crucial to EUR/USD this week. Lagarde surprised some last Thursday by elevating the importance of the PMIs in ECB decision-making. Unless there is a miraculous recovery in these (which seems unlikely), EUR/USD should stay relatively offered in a 1.08-1.09 range.

Chris Turner

GBP: Four speeches from BoE's Bailey this week

We've had a bullish view on EUR/GBP this year, largely because we had felt that the market was mispricing the Bank of England cycle. We still believe that to be the case, but the problem is that the ECB cycle has moved substantially to the downside too as the ECB has proved more dovish than we were expecting.

For this week, we have four speeches from BoE Governor Andrew Bailey. We still think the market is under-pricing the pace of the BoE easing cycle – and should Bailey add to some of his rare comments that the BoE could become more 'activist' in its easing, sterling could come under pressure. That may more be felt against the dollar than the euro, with the 1.30 level looking vulnerable for GBP/USD. Thursday's release of the UK PMI should also have a big say on whether sterling continues to out-perform or perhaps succumbs to some dovish BoE rhetoric.

Chris Turner

CEE: Cautiously bullish but the picture may go wrong again soon

The calendar is getting a bit busier than last week, but more attention should be paid to the markets than the economy and volatility in the rates market. Today sees the release of September wages and industrial numbers in Poland. While industry remains weak mainly due to external demand, wage growth remains in double digits, but some slowdown should come in the months ahead.

Tomorrow on the data front, we continue with retail sales in Poland and wages in Hungary. Also scheduled is the National Bank of Hungary rate meeting. Clearly, a rate cut is not on the table given the EUR/HUF level and market volatility. The main question is how long the pause in the cutting cycle will be. We expect another rate cut in December – however, the market is moving in a hawkish direction further out.

On Thursday, the Czech Republic will release consumer confidence for October. As we get closer to the November Czech National Bank meeting, we may also see the first board members' interviews before the blackout period starting next week.

While CEE currencies have stabilised and are reaching for modest gains, the rates market remains significantly volatile. Although pricing did not change significantly last week, low liquidity and high volatility do not indicate a stabilisation of the CEE market, and FX remains fragile in our view. Moreover, a dovish ECB, lower EUR/USD and the upcoming US election are not supportive of CEE. High rate differentials across the board should therefore be the only driver.

In turn, we are cautiously bullish, with the caveat that we are aware of CEE FX entering another dangerous environment with the approaching US election and a period of investors closing the risk. CZK remains our favorite currency in the region, supported by the strong interest rate differential, the latest current account number and possible hawkish central bank comments, which could allow CZK to outperform its CEE peers. However, the forint could also get further support from the central bank as it struggles to settle below 400 EUR/HUF.

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