FX Daily: Geopolitics just another reason to hold dollars

If US exceptionalism and the potential for a second Trump administration weren't enough to hold dollars, geopolitics and events in South Korea yesterday only add to the argument. Expect the market to keep one eye on Korea today, but also take note of central bank speakers and US data. In the CEE, we see the risk of continuing strength in CZK and PLN

Events in Korea only add to the case to hold the liquid and high-yielding dollar

USD: Rates, liquidity and geopolitics keep dollar supported

Yesterday's news of the brief imposition of martial law in South Korea came as a shock. Korean currency and asset markets play a significant role in the investment universe, where the Korean won is the 12th most traded currency in the world (BIS 2022) and its government bonds make up 9-10% of emerging market local currency bond indices. Indeed, Korea recently celebrated its inclusion into the FTSE Russell's World Government Bond Index. Global investors will therefore be closely monitoring developments in Korea over the coming days.

We were discussing this yesterday, but dollar strength is not entirely being led by the second coming of Donald Trump. A lame duck government in Germany and potentially France too today if a no-confidence vote is successful, plus this Korean news, will only add to confidence that the relatively high rates (USD one-week deposit rates at 4.6%) and liquidity make the dollar the most compelling currency in which to park cash balances right now. Yes, there is the risk that US macro data softens a little and can drag the dollar a little softer, but taking defensive positions in something like the Japanese yen (deposit rate at 0.11%) or Swiss franc (0.86%) can be expensive.

In focus for the US today is ADP employment data (1415CET) and ISM Services (16CET). The ADP number has been discredited this year, but the ISM services number occasionally moves markets. There seems no reason to see a sharp fall here and actually the JOLTS job opening data we discussed yesterday came in better than expected.

Perhaps more interesting today will be Fed communication. Fed Chair Jerome Powell speaks in a moderated *New York Times* discussion at 1940CET. And the Fed's Beige Book is released at 2000CET. Both can provide a little colour ahead of the FOMC meeting on 18 December, where the Fed looks minded to ease policy. A 25bp cut is not fully priced and softer short-dated US rates could drag the dollar a little softer. Yet there are plenty of reasons to suspect the DXY dollar index will find good buying interest under 106.00.

Chris Turner

EUR: Bearish consolidation

Having fallen nearly 8% between late September and mid-November, it is no surprise to see EUR/USD undergoing some consolidation. But we view this as a bearish consolidation rather than base-building. Be it European political risk, weak activity, the threat of trade wars or energy prices creeping higher (EU gas inventories are starting to come under pressure) there are many reasons to be underweight in the euro.

The eurozone data calendar is pretty light today, just October PPI inflation data and some final November PMI readings. But we do have ECB President Christine Lagarde speaking at the EU parliament at 1430CET. We doubt she will shed much light on whether the ECB will cut rates by 25bp or 50bp on 12 December, although 25bp looks much more likely at the moment.

Our bias would be for EUR/USD to be capped around the 1.0550 area and it would be no surprise if EUR/USD dropped back towards 1.0400 over the coming days – unless Friday's US NFP data dramatically disappoints consensus of +200/220k.

Elsewhere, we have Bank of England Governor Andrew Bailey speaking at a *Financial Times* event at 1000CET today. He occasionally errs into dovish territory but probably does not have the ammunition to do that today. Still, there are downside risks to GBP/USD from the speech – perhaps taking the pair to 1.2590/2620 on the day.

Chris Turner

PLN: NBP can deliver further zloty gains

Today in Poland we will see the decision of the National Bank of Poland. It is likely to leave rates unchanged at 5.75% in line with expectations. Also, a statement will be published which could assess the new GDP data and the government's intention to freeze energy prices, lowering the trajectory of headline inflation next year. This could give us a clue as to what tone we can expect from Governor Adam Glapinski's press conference tomorrow. Our economists see the odds growing that the MPC decides to surprise markets with the first cut in March and by 50bp rather than 25bp.

Market pricing is on the dovish side with a fully priced rate cut in March next year and roughly 20% priced for February. This comes ahead of the next NBP forecast which is a prerequisite for most MPC members to discuss rate cuts. At the same time, some MPC or board members close to the governor in recent days have made more hawkish statements. Taken together, the Governor's press conference could thus be neutral or slightly hawkish given the aggressive dovish pricing, in our view.

PLN has outperformed CEE peers since the US election and has likely surprised with strong levels thanks to short positioning in recent weeks. Although we retain a bearish view on the CEE region given the geopolitical shift post-US election, we believe that tactically PLN may see more gains. And some hawkish repricing can support the zloty despite stronger levels in recent days. Therefore, a test of 4.280 EUR/PLN is on the table for the coming days.

Frantisek Taborsky

CZK: CNB governor to repeat usual hawkish message

In the Czech Republic, the government yesterday approved the state budget for next year, as expected, which we estimate should lead to a public deficit of 1.9% from this year's 2.4% of GDP. Third quarter wage data will be released today, which we estimate rose by 4.0% YoY in real terms, similar to the previous quarter. The central bank forecast 3.6% in November. Speaking of the Czech National Bank, the governor is also scheduled to speak at a local conference today, which could give us a hint on the December decision, which remains unclear. However, we usually get a hawkish message from the governor, which could again support the CZK.

EUR/CZK quickly broke below 25.200, a level we have mentioned here in previous days, and current levels in the 25.150-200 range seem fair to us. If the governor makes it clear today that a pause in December is the more likely scenario, EUR/CZK could test 25.100. Similar to PLN, we see tactical gains here but more weakness later due to geopolitical reasons.

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