FX Daily: Glass half full

Risk sentiment is still being driven by news from China, with markets now turning a blind eye to Covid restrictions and instead speculating about an easing in tech regulation. Today, it's all about the Fed minutes, as bulls hope to find signs that Powell's hawkishness was conditional on a strong CPI reading. The USD correction may be nearing its bottom

Source: Shutterstock

USD: Ready to scan the Fed minutes

Global risk sentiment has rebounded after absorbing the news about China's new Covid wave. One factor driving the rally has been increasing speculation that China is loosening its regulatory grip on the tech sector, essentially offering a lifeline to tech shares which have gone through some rough months.

This sharp recovery in sentiment appears a bit premature in our view. While there is no clear evidence that the regulatory crackdown has taken a decisive turn (only yesterday, it was reported that China will fine Ant Group $1bn), there is plenty of evidence that Covid restrictions are rapidly being reintroduced into many parts of the country, including Shanghai.

But today, all eyes are on the FOMC minutes, the big risk event before a quieter rest of the week as the US enters the Thanksgiving holiday break. Investors will scan the minutes for indications that the "higher for longer" plan is linked to short-term dynamics in CPI releases. Expect another rally in risk assets should the minutes provide hints of conditionality of Powell's post-meeting hawkishness to a prolonged stickiness in inflation readings, which markets are now more convinced will not materialise after the latest CPI reading. In the absence of such hints, there may not be much for risk bulls to cling on to, given that the November meeting was still a largely hawkish one and the post-meeting (and also post-CPI) Fedspeak has been rather cautious on a dovish pivot.

In FX, the dollar has faced a new round of selling. We don't exclude that this correction will run a little further, but we continue to expect a rather radical inversion in the bearish dollar trend in December as the Fed remains broadly hawkish, energy prices rise again and the global economy slows.

Elsewhere in the G10, the Kiwi dollar was stronger after a 75bp rate hike by the Reserve Bank of New Zealand overnight. Policymakers signalled they will take rates to 5.5% in 3Q22, that the economy will enter a recession and that the housing market will contract by 20% (more than previously expected) from its 2021 peak. We remain doubtful that the RBNZ will ultimately deliver this much tightening and tolerate such a sharp house market contraction, but for now, it remains a clear hawkish standout in the developed market.

Francesco Pesole

EUR: Only a dollar function

The risk rally sent EUR/USD back above 1.0300. Indeed, some improvement in China-related sentiment is a positive development for eurozone assets and the euro, but swings in the pair remain primarily a function of broader dollar moves.

The eurozone's calendar includes November's PMI numbers today. Which are expected to remain rather depressed despite the easing in energy prices. Barring a major upside surprise, it appears unlikely that the release will generate a strong market reaction. The same should be true for ECB speakers (Luis De Guindos, Pablo Hernandez De Cos, and Mario Centeno) today.

The Fed minutes are the most important event for EUR/USD today, along with further changes in the market's sentiment on China. An extension of the rally to 1.0400/1.0450 is surely possible in the coming days, but a return to parity in the next few weeks remains our base case as we enter a challenging winter for the eurozone economy.

Francesco Pesole

GBP: Hunt to testify

PMIs will be released in the UK today, and the consensus is looking for a further deterioration in both the manufacturing and composite gauges, possibly due to the prospect of austerity measures by the new UK government. On this topic, Chancellor Jeremy Hunt will testify before the Treasury Committee about his Autumn Statement this afternoon.

The extended correction in the dollar is now pushing cable towards the 1.2000 gravity line. Expect some resistance around that level given the lack of strong domestic bullish drivers for the pound though. GBP's greater sensitivity to risk sentiment compared to the euro means that further improvements in global risk sentiment can push EUR/GBP to test 0.8600 in the coming days.

Francesco Pesole

CEE: The region remains quiet

Today, we expect a second round of monthly data from Poland, led by retail sales. Yesterday's data showed rather softer numbers. In our view, retail sales growth has slowed to low single-digit growth as wages are no longer keeping up with rising prices. We forecast growth of 3.8% year-on-year as high inflation is undermining consumers' purchasing power to such an extent that they are more cautious in their purchasing decisions. However, the attention grabber will be the POLGBs auction. Yields have moved down massively over the past month, completely changing the market picture. In the Czech Republic, we will see the Czech National Bank conference, including an opening speech by the governor, who rarely appears in public.

In Hungary, the central bank left rates unchanged yesterday as expected. The National Bank of Hungary repeated its "whatever it takes" stance and the short-term focus remains on market stability until an improvement in risk perception occurs. The Hungarian forint ended slightly stronger after the press conference, but the EU story holds the main role here. Thus, we continue to wait for the European Commission's decision, which should have a positive impact on the market and move the forint closer to 400 EUR/HUF.

Elsewhere, this week is more the domain of the rates market and FX remains without much enthusiasm. Impulses for bigger moves are hard to find both on the domestic and foreign side. Thus, our view hasn't changed much since Monday, and we can't expect much momentum from the region today either. The focus will thus be on the global story.

Frantisek Taborsky

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com