FX Daily: If it ain't broke, don't fix it

A winning strategy in FX markets this year has been to back commodity exporters in both the DM and EM spaces, with positions funded out of JPY or EUR. Heading into the last couple of months of the year there seems no reason to change that strategy now. For today, a quiet calendar suggests more consolidation before a more interesting Thursday/Friday.

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USD: Further consolidation in store

On a quiet day for the FX calendar, it is worth reflecting on currency performance so far this year. In the G10 space, the outperformers are the CAD and NOK. Both energy exporters, both with central banks preparing to or already tightening and both with the tail-wind for growth that the positive terms of trade provide through higher capex. The worst performers in the G10 space are the JPY and the EUR, both net energy importers, suffering the negative income shock from higher energy prices and with some of the most dovish central banks in the world. The same story holds true in the EM space, where the RUB is the clear out-performer (energy exporter, hawkish central bank) and TRY the sharp under-performer (energy importer, with a central bank cutting rates 300bp since September).

Low energy inventories for both gas and crude and no signs that supply frictions are going to be eased anytime soon suggests this story should continue to play out. EUR/RUB has fallen to the 80.50/81.00 area far more quickly than we had thought. And this bear trend may continue further - backed by 8%+ carry.

Another interesting theme expressed in the FT yesterday is that emerging market countries that enacted more aggressive fiscal spending plans during the pandemic have failed to see the benefits for growth and have been left with higher debt levels, higher inflation, and weaker currencies. Brazil, Hungary, and the Philippines were highlighted in this article. Brazil seems the stand-out here, with a 5 year sovereign CDS now near the widest levels for a year as a populist government threatens to break fiscal rules ahead of a November 2022 election. The local central bank looks set to raise rates over 100bp this week to fight inflation. Yet looser fiscal policy is making BACEN's job harder and it seems a fiscal risk premium is starting to be priced into the BRL.

Back to today, the US calendar sees US new home sales and consumer confidence. The latter will be more interesting - e.g. does it fall further? Barring a sharp fall in consumer confidence, we would say that the buoyant US equity mood can keep the dollar gently bid against the JPY and EUR, while the commodity complex can continue to do well (short speculative AUD positions could be at risk here). DXY pulled away from support at 93.50 yesterday and may now trade a 93.75-94.25 range.

EUR: Be careful what you wish for

As Carsten Brzeski points out in his ECB preview the weak Euro will mean that the ECB will have to revise up its inflation forecasts, which could cause some difficulties for an inherently dovish central bank. Wanting a weaker currency is good in a disinflationary environment, but may come with consequences for income during a commodity shock. We discuss how the Chinese might be addressing things differently here.

Yet we doubt the ECB is in any way ready to alter its communication strategy (not until December anyway) and that the EUR, with its implied yields of around -0.7% per annum, can remain a preferred funding currency.

The Eurozone calendar is light until Thursday's ECB meeting and we suspect EUR/USD drifts in a 1.1570-1.1620 range.

GBP: Holding up quite well

The pre-budget leaks have typically involved new spending plans rather than how this is going to be paid for. That does perhaps leave GBP a little vulnerable tomorrow should the UK Chancellor announce any kind of fiscal consolidation.

GBP has been performing well, however. If it can avoid a sell-off around tomorrow's budget, GBP could enjoy some strength into Friday when we could get to hear a more conciliatory tone on adjustments to the Northern Ireland protocol. And we would expect GBP to stay bid ahead of the Nov 4th BoE meeting, where a 15bp rate hike is expected. EUR/GBP support at 0.8402/25 is holding, but we tend to favour a drop to 0.8400.

CEE: Where is the love?

CE3 currencies have fallen out of favour over the last couple of weeks. The perception is that both Poland and Hungary are reluctant to hike aggressively despite a conviction view that headline levels of inflation will continue to rise over the coming months. No such concerns can be levelled at the Czech National Bank (CNB), yet EUR/CZK has also corrected sharply higher. That move cannot be blamed on a re-pricing lower of CNB tightening expectations, which the FRA market tell us has not happened.

In Hungary, the suspicion is that there is simply too much HUF liquidity out there and the central bank will need to find ways to reduce it. We will be on the lookout over the coming days for any tweaks to the monetary transmission mechanism (including HUF liquidity withdrawal) which can help stabilise the HUF. Until then, EUR/HUF could grind higher to 369/370.

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