

## FX Daily: Inflation figures carry some downside risks to the dollar

The dollar risks another correction event today as inflation may slow a bit more than expected, even though core stickiness should prevent a major repricing of rate expectations. EUR/USD might also be helped by a marginal improvement in the ZEW. Elsewhere, UK wages were good news for the BoE in our view, while Swedish inflation doesn't rule out a hike next week



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### 📉 USD: Watch for the key data correction event

Most action in the FX market today should revolve around the release of the October inflation report in the US. Consensus expectations are for a month-on-month increase of 0.1% in the headline and 0.3% in the core, with yearly rates falling to 3.3% (headline) and steadying at 4.1% (core). Our US economics team's view is broadly in line with consensus, although they highlight how the big drop in gasoline prices could allow headline MoM CPI to print a 0.0% or even a negative number if the value of retail sales was also depressed.

The stickiness in core inflation should prevent a major swing in the Federal Reserve narrative – which has been focused on reiterating its hawkish bias of late – but does surely raise the chance of

one of those dollar position-squaring events that we have witnessed around key US data releases in recent months.

While activity data mostly impacts rate cut bets further down the road, inflation figures primarily impact market expectations for the most imminent meetings. Here, there are merely 7bp to be priced out by January in terms of tightening, meaning that the implications for FX may not stretch for much longer unless there is a substantial repricing lower across the curve. We still think that the decisive blow to 'de-throne' the dollar will have to be given by a turn lower in activity data, which can make markets feel comfortable with pricing in more rate cuts. So, we will be looking with some interest at retail sales figures tomorrow. The long list of Fed speakers today and throughout the rest of the week may not steer market sentiment all that much after Fed Chair Jerome Powell made things quite clear last week.

We see some downside risks to the dollar given a potential downside surprise in CPI, and DXY could slip to the 105.20-.40 area. Expect some support mostly coming the way of procyclical currencies, while we remain unconvinced that the yen can truly benefit from slight tweaks in the US/Fed narrative at this stage. Markets appear determined to keep testing intervention levels in USD/JPY, and yesterday's drop in the pair (followed by a rebound) around the 15.00 GMT option expiry time showed similarities with the sharp fall on 3 October that did not turn out to be FX intervention.

*Francesco Pesole*

## EUR: Hoping for a glimmer of hope in the ZEW

The unattractiveness outside of its role as a procyclical alternative to the dollar given the stagnant/recessionary outlook for the eurozone has been a very central theme in FX. For this reason, any time there is a key activity-related release in the eurozone, it is an opportunity for the euro to enjoy some tentative re-rating of the rather gloomy growth expectations that are currently being priced into it.

Today, the ZEW survey out of Germany is expected to show a mild rebound. Consensus sees the "expectations" index returning above zero for the first time since April, while the "current situation" gauge is seen marginally improving. Any good surprises may build some support at 1.0700 for EUR/USD, even though the US CPI is set to be a much larger event for markets today.

The preliminary (i.e., second after the "advance") release of third-quarter euro area GDP figures is expected to confirm negative growth, but that should have a negligible market impact. On the European Central Bank side, keep an eye on speeches by two members who typically sway towards the dovish side: Chief Economist Philip Lane and French Governor Francois Villeroy. The former will participate in an Swiss National Bank event where SNB Governor Thomas Jordan is also set to speak this morning.

*Francesco Pesole*

## GBP: Wage data actually good news for BoE

A government reshuffle has dominated the headlines in the UK in the past couple of days. Among the changes made, former prime minister David Cameron returned in a cabinet role as Foreign Secretary. The market impact has been rather minimal, which is not surprising considering there were no changes in key economic posts. Our UK economist also notes how the reshuffle carries a

few obvious implications for next week's Autumn Statement, where the Chancellor may be gifted with marginally better borrowing forecasts after higher-than-expected revenues this year. That said, the headroom for tax reliefs remains limited, and we do not expect major surprises next week.

A more relevant development for sterling was the release of jobs data this morning. Wage growth was watched very closely as usual, and slowed less than expected in September from 8.1% to 7.9% (exp. 7.3%). The unemployment figures should be discarded given the data quality issues, but in general, the report points to ongoing cooling in the jobs market. This appears to be good news for the Bank of England and our economics team thinks private sector wage growth can slow down to around 4.5% by next summer.

Still, sterling is strengthening this morning on a tentative revamp of some hawkish BoE bets. EUR/GBP is heavily testing 0.8700 but will struggle to make a break lower if ZEW shows some improvement.

*Francesco Pesole*

## **SEK: Faster inflation decline raises doubts about hike**

Swedish core inflation slowed more than forecast in October according to data released this morning. While CPIF inflation accelerated – once again, less than expected – from 4.0% to 4.2%, the preferred core inflation measure by the Riksbank (CPIF excluding energy) slowed sharply from 6.9% to 6.1%.

Markets have cut the implied probability of a hike at the 23 November Riksbank meeting from 56% to 35% as a result of the release. Indeed, the good performance of the krona in the past couple of weeks – by far the best-performing G10 currency in November – is also lifting some pressure from the central bank to raise rates further at this point. Our stance on SEK's stance is clear though. FX hedging operations are offering an edge to the krona over other pro-cyclicals in the short term and in an improving risk environment, but those operations should end by February anyway – meaning this is not a sustainable driver of currency appreciation. In other words, another hike remains an important step to a SEK strengthening.

There is, then, the question of SBB, which posted widening losses in the third quarter and is facing repayment demands by some bondholders. The Riksbank, however, has not warned of a contagion effect, and anyway said that banks can continue to handle “significant” CRE problems.

All in all, we are still inclined to think the Riksbank will hike next week, although we admit this is closer to a 50/50 call at this stage. Tomorrow's Prospera inflation expectations survey results will help us make a final call. For now, SEK weakness seems limited after the inflation release, probably given expectations of Riksbank FX selling later this morning.

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