

FX Daily: Inverted curves and softer oil prices favour defensive currencies

A very inverted US yield curve and Brent crude trading down near \$80/bbl tell us that markets are growing more concerned about global demand trends. And uncertainty in China does not help either. We feel scheduled events and data in the US this week may also deliver a little support to the dollar. In general, we favour defensive positions in FX this week



📈 USD: Fed-speak, prices and employment to dominate

The week starts with a focus on events in China as local authorities struggle to battle rising daily case numbers and enforce lockdowns. While a disorderly exit from China's Covid Zero policy could ultimately prove a positive for global demand, getting to that point will be an exceptionally bumpy ride for the world's financial markets. As it stands currently, events in China are being read negatively for demand trends, where for example Brent crude and industrial metal prices are under pressure. Brent at \$80/bbl is a little surprising given what should be the 2mn barrel per day production cut [undertaken by OPEC+ this month](#).

Another big read for global demand trends is the shape of the US Treasury yield curve. The current 2-10 year inversion of the curve to -80bp is exceptional and aptly reflects investors' views that recession is coming but the Fed will not be cutting rates anytime soon. On the subject of the Fed, the week ahead sees Federal Reserve Chair Jerome Powell speaking on Wednesday evening (hawks James Bullard and John Williams speak tonight also). Currently, we would pin Chair Powell to the hawkish end of the Fed spectrum and our colleague, James Knightley, thinks [Chair Powell this week could push back](#) against the recent (and perhaps premature in the Fed's mind) easing of financial conditions.

In addition to Fed-speak, the US data calendar picks up again this week, with readings on house prices, confidence, PCE inflation and Friday's release of the November jobs report. The more important data releases come on Thursday and Friday, where any uptick in the core PCE price data or strong job numbers could support potentially hawkish rhetoric from Chair Powell and send US yields and the dollar higher again.

As we outlined in our [2023 FX Outlook](#), we just do not see conditions in place for a benign dollar bear trend - even though the buy-side is desperate to put money to work away from the dollar. Seasonally, the dollar is weak in December, but our call is that this year, the dollar can strengthen into year-end. We continue with the view that any weakness in DXY towards the 105.00 area this week (DXY now 106.18) will prove short-lived and favour a return to 108-110 into year-end.

Chris Turner

➔ EUR: Waiting for the next inflation print

The highlight of the eurozone data calendar this week will be November price data - released for Germany tomorrow and for the eurozone on Wednesday. The question is whether inflation will fall back from the highs (not far from 11% year-on-year) and allow the European Central Bank to potentially soften its hawkish rhetoric a little. Currently, the market prices a 62bp rate hike on 15 December.

EUR/USD is consolidating at higher levels - having been buoyed by the 20% recovery in European equity markets amidst declining energy prices. Equally, business confidence has been holding up a little better than expected. We cannot rule out EUR/USD trading back up to the 1.0480/1.0500 area again (though the reasons for that are far from obvious) but reiterate that the second half of the week could potentially push EUR/USD back to the 1.02 area.

Chris Turner

➔ GBP: Settling down

Three-month GBP/USD traded volatility prices are now under 12% having been near 19% in late September. Clearly, sterling trading conditions have settled down even as recession expectations solidify. Our view is that these GBP/USD gains will not last and we would not be surprised to see fresh selling interest emerging near the 200-day moving average at 1.2177 or at best the 50% retracement of the 2021-22 drop - at 1.2300.

The current inversion in yield curves around the world does, for a change, look to be a likely harbinger of recession. And with its large current account deficit, sterling should be expected to remain vulnerable. The UK data calendar is light this week, but there are a few Bank of England

(BoE) speakers who may reiterate hawkish leanings. The market currently prices a 52bp BoE rate hike on 15 December.

Chris Turner

📌 CEE: Hungary remains topic number one

The Central and Eastern Europe (CEE) region will become more [interesting](#) in the second half of the week, while today and tomorrow will be more about global numbers. On Wednesday, Poland will see the release of inflation for November and a detailed breakdown of 3Q GDP, which positively surprised a couple of weeks ago in the flash estimate (0.9% quarter-on-quarter). Of course, given the pause in the central bank hiking cycle, the CPI print will get a lot of market attention. We expect an unchanged 17.9% YoY reading, more or less in line with market estimates. On Wednesday, we could hear something new from the European Commission (EC) on Hungary, progress with the rule-of-law and access to EU funds. Thursday will see the release of PMI indicators across the region. While we expect a rebound from the lows in Poland and the Czech Republic, we forecast a drop below the 50-point level in Hungary. Also on Thursday, the 3Q GDP breakdown will be published in Hungary, which was the only country in the region to surprise negatively in the flash reading (-0.4% QoQ). On Friday, the Czech Republic will also release the detail of 3Q GDP, which was -0.4% QoQ in the first estimate as the market expected.

In the FX market, conditions for the CEE region improved again last week. The dollar index touched new lows and sentiment improved again in Europe. On the other hand, local conditions remain negative. Interest rate differentials across the region have reached new lows again in recent days.

This week, we see a chance for a reversal in the US dollar and a reality check inflation story at the global and regional level, resulting in negative pressure on the region. The European Commission decision will be a key market mover for the Hungarian forint. Although last week's news was mixed, we see it as rather positive. Thus, confirmation that Hungary no longer faces a permanent loss of EU funds should help the forint move back closer to 405 EUR/HUF. Inflation in Poland will be key for the zloty and the possibility for the market to reassess the priced-in cuts next year, which could add short-term support for the zloty. However, we see the zloty as the most vulnerable to the global story at the moment, so we remain bearish.

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