

## FX Daily: Is next week's ECB cut really a done deal?

Markets are almost fully pricing in an ECB cut of 25bp next week, but our economics team finds a few counterarguments that suggest the meeting may be a closer one than what pricing suggests. Today, Schnabel might want to clarify her remarks from last week which were interpreted as dovish. EUR/USD may rebound above 1.10 today, but downside risks persist



The ECB's Isabel Schnabel

### 📌 USD: Looking outside of the US

The start of the week has been quite mixed in FX, with the low-yielding JPY and CHF rising and the high-beta AUD and NZD under additional pressure. The Chinese markets have reopened after a long holiday with another strong session as recent expansionary measures by Beijing continue to help sentiment in the region. That can weigh moderately on USD today, even though our view for the rest of the month remains generally constructive on the dollar, [as discussed yesterday](#).

We have observed some quite limited spillover into FX from US 10-year yields hitting the 4% mark, which appears as the tail of the payroll-induced move that has already triggered some sizeable positioning readjustments in dollar crosses. There is a possibility that the FX market will take a

break from being driven by rates now that the new, shallower 25bp per-meeting rate path by the Fed has become the market baseline. We suspect inflation data this week won't prompt big directional changes in the dollar, which may instead respond more to the Middle East turmoil, and consequent moves in oil prices.

Still, we'll be on the lookout for surprise reads in the NFIB Small Business surveys today, where the hiring plan sub-index has had a decent correlation with private payrolls. Our call remains a stabilisation in DXY around 102-103 with upside risks, even if we see a slightly lower dollar today.

*Francesco Pesole*

## 📈 EUR: Watch for a Schnabel clarification

Markets are virtually fully pricing in an ECB rate cut next week (23bp), but our economics team discusses [here](#) how the decision may well be much closer than the rates market suggests. That's because the ECB already incorporated weaker growth and inflation below 2% in its latest projections, and while Isabel Schnabel's latest speech focused on growth downside risks, she also remarked how monetary policy could do little to ease those risks. Incidentally, single-country data keeps pointing to sticky services inflation, and the recent oil price rise means a potential revision higher in the inflation forecasts at the next round of staff projections.

Markets are hardly ignorant of these factors, but are equally hanging on to dovish comments by ECB members like Villeroy and probably also the view that they can push the ECB into a cut by pricing it in fully on meeting's day. There is an ECB meeting chaired by Isabel Schnabel today, and we'll be interested to see whether she wishes to clarify her stance. A hawkish re-tuning on her side can send EUR/USD back above 1.10, but we are not sure markets will be giving up on an October cut very easily and the wide USD:EUR rate gap still points to some pressure on EUR/USD in the near term.

*Francesco Pesole*

## 📉 RBNZ: A pre-emptive 50bp cut

The Reserve Bank of New Zealand (RBNZ) announces monetary policy overnight (0200 BST), and both markets and consensus are leaning in favour of a 50bp rate cut. As discussed in [our meeting preview](#), we agree.

The RBNZ has to operate with quite limited information on inflation and the jobs market, on which official data is only released quarterly. The only hard data input since the surprise August 25bp cut has been the second-quarter GDP report, which showed negative growth (albeit slightly better than consensus). That may well be enough to add pressure on the RBNZ to take rates to neutral at a faster pace, especially after the 50bp cut by the Fed in September.

A half-point cut before seeing third-quarter inflation figures obviously requires substantial confidence in the disinflation process. We see high risks of headline CPI having moved below 2.0% in the third quarter, which would make the real rate uncomfortably high if the RBNZ doesn't keep cutting.

Markets are pricing in 45bp for this meeting, and 91bp in total by year end. We think a 50bp will add more pressure on the underperforming NZD, which may be trading closer to 0.61 than 0.62 once we get to the US election risk event.

Francesco Pesole

## ➔ CEE: Can the Czech central bank pause in December?

Yesterday's data across the region was rather stronger than expected but still does not offer much optimism on the CEE economy. Today's calendar in the region does not have much to offer except retail sales data in the Czech Republic. CEE FX is again slightly under pressure coming from Friday's EUR/USD move lower in our view and lingering geopolitical risk aversion. However, we believe inflation numbers in the second half of the week could return markets to the local story.

Perhaps the most interesting will be inflation in the Czech Republic, where our economist in Prague, David Havrlant, expects inflation to rise from 2.2% to 2.4% year-on-year, in line with market expectations. However, the risks are to the upside due to uncertain energy, food and housing prices. The problem is that there is a strong base effect in the coming months and the September number will significantly define the rest of the year and the Czech National Bank (CNB) rate path. David's baseline assumes a pause in the cutting cycle in December and February mainly because of the risky inflation numbers in December and January and the lag in releases.

Although my view is mixed on this one, looking at just normal seasonal movements and base effects, 3% inflation becomes a realistic forecast and a risk zone for the CNB, which after 275bp of cuts delivered may indeed consider a pause despite weak economic data. Although the market has priced out a lot of the CNB easing over the past two weeks, the terminal rate priced in is around 3.00-3.25%. This is close to our forecast but I still think a pause in the cutting cycle would be a negative surprise for the rates market but positive for the CZK despite the weak economic data. The koruna has so far proven to be the most resilient currency in the current sell-off in the CEE and EM space and I believe EUR/CZK will return to 25.00 once global markets calm down. Moreover, should the CNB confirm this hawkish approach, the CZK could see significant support.

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