

FX Daily: Let the roller coaster continue

The pound's elevated volatility looks set to stay as contradictory signals from BoE Governor Bailey and a media report about the extension of the emergency gilt-buying programme have left markets in limbo. More clarity may come from BoE speakers today, but the downside risks for sterling continue to prevail, and the spillover can be seen globally



USD: Fed minutes in focus

The IMF delivered a warning signal yesterday as it cut its year-ahead world GDP forecast for the third time this year, from 2.9% to 2.7%. Interestingly, the theme of excessive tightening and the damage to the world's economy has taken a more central role in the IMF report. It seems, however, quite far from the rhetoric of the Federal Reserve and most other central banks, which continue to point to the need to fight inflation while accepting a degree of economic damage.

This is the narrative that is keeping the general trend in risk assets bearish and the dollar supported, and we do not expect it to change until 1Q23 at the earliest – as discussed in our [latest](#)

[monthly FX update.](#)

So far this week, extra US drivers have been more relevant for global markets and dollar swings, and most of the focus will remain on developments in a) the UK bond market and the GBP impact; b) the re-escalation in the Ukraine conflict; c) Asia's tech stocks after fresh export restrictions by the US.

Domestically, the US calendar includes PPI for September and the 21 September FOMC meeting minutes. The latter should, in our view, show some good degree of alignment within the committee around the need for another large (75bp) move in November, although diverging members' expectations around the terminal rate may trigger some adjustments in the early/mid-2023 Fed funds pricing. Anyway, we don't see any dollar correction being more than short-lived, especially considering the risk-averse developments in Europe and Asia.

Francesco Pesole

📌 EUR: EU members indecision is not good news

The highlight of the day in the eurozone is the speech by European Central Bank President Christine Lagarde at the IIF annual meeting in Washington. With two weeks to go to the October ECB meeting, markets are almost fully pricing in a 75bp hike (70bp embedded in the OIS curve) and a total of 230bp of tightening by mid-2023. There is a high probability that Lagarde will refrain from giving strong signals to the market, and in any event, the implications for the euro should not be very large given the currency has been significantly less sensitive to domestic monetary policy expectations lately compared to historic standards. We'll also hear from Klaas Knot and Pablo Hernández De Cos later in the day.

We think that the ongoing discussion among EU members about price caps on energy prices is set to have broader implications than the ECB rhetoric at this stage. It still appears that member states cannot agree on the design of an EU-wide measure, with proposals ranging from a radical cap on imported gas prices (here, the issues would be higher demand and issues with non-Russian suppliers), to a floating price corridor to avoid excessive volatility, to a less drastic support package to shield the economy from large energy bills (at the risk of straining public finances). Lingering indecisiveness is not good news for the euro, and we still see downside risks into the September lows in EUR/USD (0.9540) this week.

Francesco Pesole

📌 GBP: Awaiting clarity on BoE emergency purchases

The roller coaster ride in GBP looks far from over. Yesterday, Bank of England Governor Andrew Bailey surprised by announcing that emergency gilt purchases will be discontinued – as scheduled – at the end of this week, adding that pensions funds had only three days to close their liquidity positions. The remarks triggered a drop in the pound below the 1.1000 threshold and back-end gilts came under new pressure.

UK markets are now assessing the credibility of a report by the Financial Times that the BoE communicated privately to banks that the emergency buying programme may actually be extended beyond this week. GBP rose on the news and is currently trading at the 1.1000 mark, but that appears to be a sort of "limbo" level where markets are awaiting more clarity on this theme.

Our rates team notes that Bailey's speech and the FT report are indeed contradictory but not entirely inconsistent, as the BoE is likely fearing that the pledge of longer-term intervention would discourage pension funds to de-lever.

Today, speeches by MPC members Jonathan Haskel (0900 BST), Huw Pill (1235 BST) and Catherine Mann (1800 BST) will be very closely watched. It does appear that the extension of the emergency gilt buying is currently holding the key to averting another sharp sell-off in the gilt market and the pound. We should expect more volatility in the pound for today, and we continue to see the direction of travel as mostly negative, with cable set to drop to the 1.00-1.05 area by the end of the year.

On the economic side, things aren't offering much support either, as this morning's data showed a surprise economic contraction by 0.3% month-on-month in August, paired with a large slump (-5.2% YoY) in industrial production.

Francesco Pesole

📌 KRW: Rising dissent within the BoK

The Bank of Korea [hiked](#) the 7-day repo rate by 50bp this morning. This was largely expected but for the first time since August 2021, the decision was not unanimous, with two members dissenting, which signals a widening of the hawk-dove spectrum as the inflation-growth dichotomy becomes increasingly relevant.

While acknowledging a non-negligible risk of another 50bp rate hike in November, our Asian economics team expects a continued slowdown in pipeline prices to allow the BoK to normalise policy at a slower (25bp) pace next month. Our FX view remains unchanged: the fallout of China's economic woes and a strong dollar should continue to put upside pressure on USD/KRW, and we forecast 1500 by year-end.

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