

FX Daily: Middle East conflict may provide another leg up to the dollar

Horrific events in southern Israel at the weekend have lifted oil prices and raised concerns of escalation across the broader region. This comes at a time when the oil market balance is already in deficit and the US economy is running close to full employment. For FX markets, this should be another positive for the dollar



USD: More support for the dollar

The horrific events in southern Israel this weekend have seen oil prices rise and concerns will undoubtedly build over an escalation in the region. As Warren Patterson discusses in his [oil note today](#), questions will be asked as to Iran's involvement in the Hamas attack and how both Israel and the US respond. At around three million barrels per day, Iran is proving to be this year's key marginal supplier of oil, and a further geopolitical risk premium could be built into crude should sanctions against Iranian crude be enforced more vigorously or any more direct form of response take place.

Higher oil prices will add further support to the dollar in that they will weigh on global growth, and

the IMF should lower global growth forecasts this week. They will also add to inflationary pressure, which will be most acute in the US given the least spare capacity. They will again drive a wedge between the 'haves' (US) and the 'have nots' (Europe and Asia) when it comes to oil self-sufficiency.

Away from developments in Israel, Friday delivered a [very strong US jobs report](#) which looks set to keep the Federal Reserve in hawkish mode for a little longer. The data will also keep US Treasuries under pressure in a week in which we see \$101 billion of three, ten and thirty-year Treasuries being auctioned. 5% US ten-year Treasury yields remain a very real threat and stand to tighten financial conditions still further. Other US highlights this week include a whole host of Fed speakers (Fed hawk Lorie Logan speaks at 3:00 pm CET today), FOMC minutes on Wednesday, and both CPI and PPI data releases. None of these look particularly threatening to dollar long positions.

On balance, we expect DXY to find good support near 106.00 this week. As we discuss in the October edition of FX Talking – [Bond vigilantes take control](#) – it looks as though the dollar can stay strong into year-end despite November and December being seasonally weak months for the dollar.

Chris Turner

↓ EUR: On the wrong side of the oil story

We would say 1.0400-1.0600 looks to be the near-term trading range for EUR/USD. The test of 1.0600 post Friday's jobs report was a surprise, but there is no getting away from the higher US rate story and also increasing headwinds to world growth. One left-field event risk this week, however, is the start of the US banking earnings season. How US banks cope with the sharp losses in US Treasuries will be of interest following the failure of three US banks in March. We expect to hear more on this issue over the coming weeks.

The eurozone calendar is pretty light this week. We have the October Sentix investor survey reading today, several European Central Bank speakers throughout the week, and on Wednesday, we'll see the latest ECB reading on consumer inflation expectations. As for ECB policy, the market has virtually priced out the prospects of any further tightening and it seems as though the story has moved on to looking at possible Quantitative Tightening from the ECB, the potential re-introduction of the Stability and Growth Pact and what this all means for peripheral eurozone debt markets.

Chris Turner

→ CEE: September inflation prints in the region

On the data front, today we will see the industrial production result for August in the Czech Republic which will also offer data from the labour market important for the central bank. Later, Hungary's state budget numbers will be released. Tomorrow, we'll have [inflation](#) in Hungary and the Czech Republic for September. In Hungary, we expect a drop from 16.4% to 12.4% year-on-year, in line with market expectations but slightly above the National Bank of Hungary's expectations. In the Czech Republic, we will also see a jump down from 8.5% to 7.2% YoY, slightly above market expectations but in line with the Czech National Bank this time.

On Thursday, we will also see inflation in Romania, which after stagnating in August should

continue to fall from 9.4% to 8.5% YoY in September. In Romania, we will also see the final second-quarter GDP numbers. Current account data across the region will be released throughout the week.

On the sovereign rating side, on Friday S&P will release reviews for the Czech Republic (AA-) and Romania (BBB-). In both cases, we think the rating and outlook will remain unchanged.

In the FX market, the CEE region is balancing between a strong US dollar and more favourable interest rate differentials. However, we are unlikely to see a clear winner in this contest this week. The Polish zloty is still settling after last week's [National Bank of Poland meeting](#) and while it closed at new strong levels on Friday, the press conference suggests further rate cuts, so support for higher rates in the market will not last long in our view. We therefore expect a return above 4.600 EUR/PLN. On the other hand, we think the Czech koruna has outpaced the rate drop at the short end of the curve and we think it will move back towards 24.450 EUR/CZK. More interesting will be the Hungarian forint. While we don't see any mispricing at the moment, tomorrow's inflation could confirm the NBH's hawkish bias – which should also help the currency to further gains towards 384 EUR/HUF.

Frantisek Taborsky

➔ ILS: Bank of Israel supports the shekel

The Israeli shekel has understandably come under pressure after the weekend's attack from Hamas. The shekel has actually been quite weak all year, and prior to the weekend, the Bank of Israel (BoI) had estimated that there could be a 10% risk premium in the shekel on the back of the government's contentious plans to reform the judiciary. Up until today, the BoI had not intervened to support the shekel.

Today, however, the BoI announced that it is prepared to sell up to \$30 billion from its \$203 billion FX reserves to support the shekel. The BoI is one of the more interventionist central banks and we presume they will try to drive USD/ILS back under 3.90.

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