

FX Daily: Peak optimism versus peak pessimism

US retail sales has confirmed that the US strong activity narrative remains untouched. However, the dollar has corrected lower, which may well be down to positioning adjustment. Markets might be starting to think the US is at peak optimism, and that peak pessimism in the eurozone and China is past us after a tentative rebound in data



Federal Reserve Board Governor Christopher Waller is among those scheduled to speak today

📌 USD: Only a positioning tilt?

The strength in US activity data appears relentless, with yesterday's retail sales figures for September smashing estimates (0.7% month-on-month) while the August print was also revised higher. Our economist points to some inconsistency with evidence of declining credit card spending in September, as well as weakening consumer confidence. Ultimately, our core view remains that the shrinking disposable income and reduced credit availability will translate into weaker consumer spending figures. For now, however, consumer data has all but fuelled the US economic resilience narrative.

The moves in FX have been somewhat counterintuitive after the release. The dollar did not rally very aggressively after the retail sales figures yesterday, with the exception of USD/CAD, which was driven temporarily higher by softer-than-expect Canadian inflation figures. Still, we saw the 2-

year USD swap rate jump 12bp to 5.08%, close to a previous 8 March high (5.15%) before correcting marginally to 5.05% overnight. 2-year treasury yields moved to the highest level since 2006, at 5.2%. While USD/JPY stayed supported, AUD and EUR both rallied yesterday, in what appeared to be a pro-cyclical turn in sentiment. There is a chance that some developments in the Middle East with a pinch of optimism (e.g., Biden's trip to Israel potentially helping to ease tensions) may have taken some momentum off the safe-haven dollar, but we would have probably had to see some more weakness in the likes of the Swiss franc if that was the case.

The seemingly dwindling treasury yields-USD relation was more likely due to some positioning readjustment. That readjustment favoured the three G10 procyclical currencies that were not facing other negative factors yesterday: EUR, AUD and SEK. Among the others, CAD and NZD suffered from soft inflation figures, NOK from softer oil prices (before this morning's rebound), and GBP from lower-than-expected wage growth.

We are seeing the dollar weaken across the board this morning after Chinese data (third-quarter GDP, September industrial production and retail sales) surprised on the upside. The China growth factor has been a quieter driver of market moves recently, but today's figures seem to favour the view that the worst is past us when it comes to Chinese data pessimism. We keep favouring AUD as a proxy trade, although jobs figures overnight will prove to be a key risk event, given that markets still have some 15bp of RBA tightening to potentially price out in case of soft print.

We could see some China-related optimism spilling over equity performance today and keep some pressure on the dollar, even though the big jump in US short-term yields suggests the downside room for the dollar probably remains limited for now. The US calendar today may not move rates and FX as much as yesterday, and a lot of focus will be on diplomatic developments in the Middle East. Aside from some housing figures, the highlight in the US will be on the Fed Beige Book. We'll keep a close eye on Federal Reserve speakers as usual, although the recent rebound in yields makes any hawkish diversion in the language less likely. Christopher Waller, John Williams, Michelle Bowman, Thomas Barkin, Patrick Harker and Lisa Cook are all set to speak today.

Francesco Pesole

EUR: A tentative turn in data

The eurozone sees the release of the final inflation figures for September, with consensus expecting a confirmation that core CPI was 4.5%, in line with the core estimates. We are observing some tentative return of appetite for long euro positions in the market, despite lingering evidence of US activity strength. Yesterday's better-than-expected ZEW survey figures might have fuelled a narrative that we have already touched peak pessimism in the eurozone, similar to what we are observing with Chinese sentiment. By contrast, markets might start to think optimism on the US growth story is also close to the peak and are anticipating a rotation back into EUR/USD.

We still deem a sustainable EUR/USD rally premature, given the strong (and growing) USD rate advantage. Improvements in the eurozone growth narrative would help, but a weakening in US data remains the key to unlocking major upside room for the pair.

With Chinese data helping today, we could see some support above 1.0600 coming today. The volatile situation in the Middle East remains a big question mark on the direction for the pair in the short-term though.

Francesco Pesole

📈 GBP: Slight CPI surprise not enough for November hike

UK inflation figures for September came in slightly higher than expected this morning. Headline CPI grew 6.7% year-on-year like in August, while core slowed marginally from 6.2% to 6.1%. Our UK economist believes that, despite marginally beating consensus, there is probably nothing in this inflation report that would push the Bank of England into [another hike in November](#).

Services inflation (the main focus for the BoE) came in at 6.9%, fractionally below the Bank's own forecasts, and there was a big contribution from volatile package holiday prices while more stable categories were less surprising. We still forecast services CPI ending the year at 6% thanks to the lagged impact of lower gas prices.

Sterling is trading higher after the release, as markets now price in 50% chances of another hike before year-end. EUR/GBP may correct a bit lower on the back of some hawkish BoE rate expectation repricing today but is then probably heading higher into the BoE meeting as we expect a hold.

Francesco Pesole

📉 CEE: Higher cores indicate weaker FX in region

Today's calendar in the region is basically empty. The only interesting data was released this morning in Romania. Industrial production fell by 1.2% YoY and continues its downward trend. However, the more interesting picture is found in the FX market, which was caught off guard by higher US retail sales and a sell-off in rates in our view. Today, we can see the echoes in both rates and FX in the CEE market. The general deterioration in rate differentials indicates weaker FX across the region unless CEE rates try to catch up with yesterday's rise in core markets. For now, we are slightly bearish on CEE FX. This could see EUR/CZK touch 24.70 again, EUR/PLN return to 4.45 and EUR/HUF erase its losses to 386.

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