

## FX Daily: Preparation week

This week will prepare markets for the last key events of the year: policy meetings by the Fed, ECB and BoE on 14-15 December. It looks like the dollar's long positioning has now completely faded, and three factors - the Fed remaining hawkish, China's optimism being misplaced and energy prices rising again - could contribute to a USD re-appreciation



European Central Bank president Christine Lagarde and US Fed chair Jerome Powell

### ➔ USD: Balanced positioning

The dollar index is now trading 8% off its early November high, and it can't be excluded that a busy couple of weeks before the festive period will continue to put some pressure on the greenback, which is incidentally seasonally weak in December. This is, however, not our base case, as we suspect instead that the dollar correction may have run its course, and several factors should allow for some re-appreciation into year-end.

- First, markets have speculated about a dovish pivot from the Federal Reserve after signs of slowing inflation, but our suspicion is that the Fed will maintain its hawkish narrative for longer, implicitly or explicitly protesting against the recent drop in yields. Strong jobs numbers on Friday should offer a basis for this. After all, endorsing the market's dovish narrative may be premature and risky for the Fed whose plan should be to let markets do

the heavy lifting in tightening - and our rates team is bearish on Treasuries in the near term. A still highly inflationary global environment may struggle to live with sub-3.50% 10-year yields.

- Secondly, USD/CNY is trading below 7.00 for the first time since September, with the yuan following Chinese risk assets higher after the government announced an easing of Covid rules. The government's move appears to be a direct consequence of recent demonstrations against its Covid policy, but a further untightening of restrictions may prove complicated. Many parts of the country - including Beijing - are facing a surge in cases, and the vaccination rates (especially booster doses) among the elderly still look insufficient. At the same time, the real estate and export sectors remain a key concern for the medium outlook in China, and one that may prevent the yuan from appreciating much further.
- Third, with Russia rejecting the cap on oil prices at \$60/bbl and threatening output cuts, along with a projected drop in temperatures in many parts of Europe, the energy crisis may return and we see ample room for gas and oil prices to climb back. That would be a positive development for the dollar.

Today, the US calendar includes ISM service figures for November, while PPI and University of Michigan survey numbers are the other major releases to watch this week. There are no Fed speakers as the pre-FOMC blackout period has now started.

According to our calculations based on CFTC data, the dollar's aggregate positioning against G10 currencies is now neutral, and at the lowest levels since August 2021. With more limited room for position-squaring effects to weigh on the dollar, our view for this week is that we could see at least some stabilisation in the greenback. DXY may struggle to extend its drop below 103/103.50, and a rebound to 105.50/106.00 looks more likely in our view.

*Francesco Pesole*

## ➔ EUR: Energy scares coming back?

The eurozone's calendar lacks market-moving data this week, and only includes some final releases (GDP, PMIs). However, we'll get a chance to hear the last few comments by European Central Bank officials before the 15 December policy meeting. Markets appear to have reinforced their 50bp expectations over 75bp, especially after the latest deceleration in eurozone inflation which makes the hawkish rhetoric harder to defend.

However, energy-related news should be more relevant for the euro this week, with falling temperatures in Europe and the price cap on Russian oil coming into effect today. Urals grade crude is trading around \$10 below the \$60/bbl cap, but Russia has already announced that it would prefer to trim production rather than sell at the embargo price. OPEC+ has held production steady and is only scheduled to meet again in February, but we continue to see risks that a tighter picture in the energy market in 2023 could lead to higher oil and gas sooner rather than later. Given the high sensitivity of EUR/USD to the eurozone's terms of trade (which is primarily driven by energy prices), further upside risks for energy commodities equal downside risks for the euro.

This week, some dollar stabilisation could make the EUR/USD rally run out of steam around the

1.0600/1.0650 area, and possibly lead to a more sustainable drop below 1.0450/1.0500. We remain bearish on the pair into year-end.

*Francesco Pesole*

## ➔ GBP: Cable is still a dollar story

Markets have aligned their expectations for the Fed, the ECB and Bank of England's December rate hikes at 50bp. There is only a residual 7bp of extra tightening in the OIS curve for the 15 December BoE meeting, and our call is also for a half-point move.

Rate expectations are unlikely to be stirred this week given the BoE has entered its quiet period and there are no major data releases in the UK.

We struggle to see cable extend its rally to 1.25 and beyond, but it will undoubtedly be primarily a dollar/risk sentiment story driving the pair before the BoE meeting. A contraction below 1.20 seems more appropriate given global and UK macro fundamentals.

*Francesco Pesole*

## ➔ CEE: Ecofin may close the Hungarian saga

This [week](#) will kick off with the release of wage growth in the Czech Republic, a key number for the Czech National Bank given that a wage-inflation spiral is a major risk for the board. The central bank forecasts 6.1% in nominal terms; we expect a number closer to 8.0% year-on-year. However, we don't believe this will be enough to trigger a hawkish reaction. On Tuesday, EU finance ministers may vote on a European Commission proposal to freeze Hungary's access to EU funds. On Wednesday, we will see industrial production results in the Czech Republic and Hungary where we expect to see slowing but still solid numbers. In Romania, a breakdown of 3Q GDP will be published and later we will see the National Bank of Poland's decision. After the publication of [inflation](#) last week, which surprised to the downside, we can expect nothing but a confirmation of the end of the hiking cycle. Then on Thursday, November inflation in Hungary will be published. We expect a further jump in YoY numbers from 21.1% to 22.4% and a similar jump in core inflation, in line with market expectations.

In the FX market, the CEE region remains well supported by the external environment, despite our expectations, especially thanks to the weak US dollar, which remains a question mark for this week. At the local level, the main themes remain the same: Hungarian forint and Polish zloty.

In Hungary, FX remains mainly driven by the EU story and we should see new headlines this week. However, the markets are visibly losing patience, resulting in high volatility, which we expect this week as well. Positioning in our view became more balanced last week, creating room for a new rally if we hear positive news, which is our baseline. In this case, we expect the forint to return below 405 EUR/HUF.

In Poland, the main topic will of course be the NBP's meeting, which will again test the market's willingness to accept the decision to end the hiking cycle. The massive rally in rates and POLGBs last week following the release of inflation data further widened the gap between the zloty and interest rate differential. FX thus remains vulnerable, in our view. We remain bearish with expectations for the zloty to return above 4.72 EUR/PLN.

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