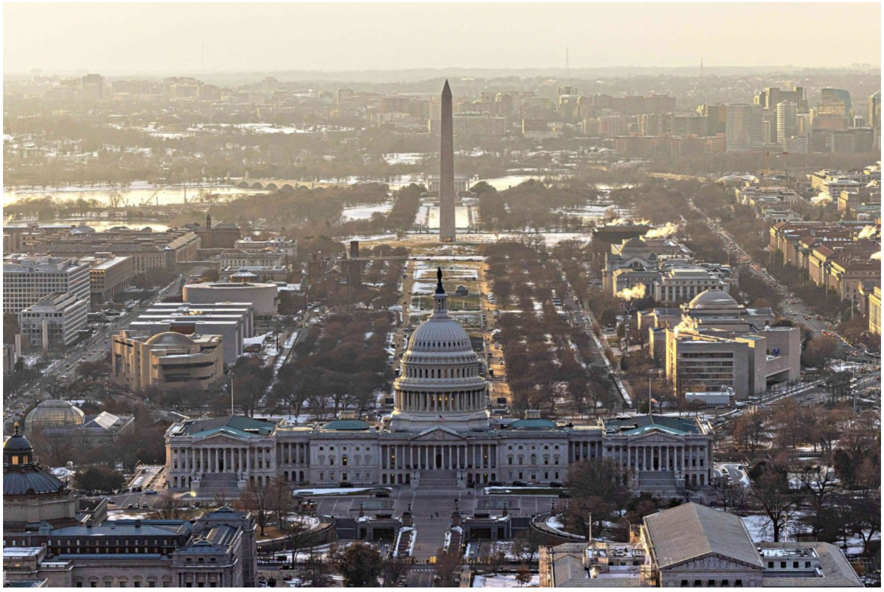
FX Daily: Prepare for another abnormal week

There has been very little progress towards ending the US government shutdown. This means more data delays and an exacerbated focus on other market events this week, including the FOMC minutes and a slew of G10 central bank speakers. We don't expect any major breaks in the dollar, and we wouldn't chase USD/JPY much higher despite political events



A lack of progress in the US government shutdown story will likely prompt other market events to take centre stage this week

USD: Resilient, but still facing downside risks

Weekend news suggests very little progress towards ending the US government shutdown, which means further delays in government-issued data. This will probably be another abnormal week in FX, with the pause in most data releases meaning an outsized focus on other macro news.

Federal Reserve pricing for December remains just short of 50bp (46bp this morning), close to the median Dot Plot. The event with the greatest market impact potential is the release of Fed minutes from the September meeting on Wednesday. What we'll be looking for in the minutes is evidence that Chair Jerome Powell's cautious view on further cuts is shared by the majority of the FOMC. The risks appear slightly tilted to the dovish side and therefore to a negative USD reaction to the minutes.

In general, the longer the US government shutdown continues, the more the dollar can face some pressure. But we must also acknowledge that the dollar has shown decent resilience so far, confirming our perception that markets have considerably raised the bar for how bad US news needs to be to build more USD shorts.

This makes us believe the dollar may not show much idiosyncratic volatility in the coming days, despite facing downside risks. Domestic stories can instead steer other G10 currencies, as we are seeing happening in Japan today.

Sanae Takaichi's election as prime minister after a leadership vote is placing the focus firmly on reflationary policy in Japan – which is weakening the yen, steepening the JGB yield curve and sending the Nikkei some 5% higher. Her election was somewhat of a surprise, and the yen's 2% drop versus USD is a testament to that.

However, we don't see much more upside room for USD/JPY from here. A much weaker yen stands to add to Japan's cost of living concerns; the rally in USD/JPY could cause friction with Washington, and the yen may still be preferred should the US government shutdown last longer. Our base case is that this break above 150.0 is temporary, rather than the start of a more sustained rally in USD/JPY.

The week will be busy with G10 central bank speakers. Powell will give opening remarks at Thursday's Fed Community Bank event, where other FOMC members, including Michelle Bowman, are set to speak. We'll also hear from the heads of the European Central Bank and the Bank of England (both today), Norges Bank (tomorrow), and the Reserve Bank of Australia (Friday), alongside other Fed speakers throughout the week. On Wednesday, the Reserve Bank of New Zealand announces policy, and we expect a 25bp cut, as per our preview.

Francesco Pesole

EUR: Rangebound activity may continue

EUR/USD has struggled to find a catalyst for a big break higher – i.e., above 1.180 – despite some accumulation of negative US news. As discussed above, the bar to sell dollars appears higher, and the euro is lacking a highly compelling idiosyncratic story.

We could see the pair continuing to stall around current levels, even though the balance of risks remains on the upside due to the US shutdown and potentially dovish Fed minutes. We see a good chance of the pair hovering in the 1.168-1.176 range in the coming days.

Don't expect much data input from the eurozone this week. ECB speakers will attract more interest, starting with today's speech by President Christine Lagarde. However, recent inflation figures have simply confirmed that the ECB is fine where it is with rates – so we don't expect to hear anything new on policy guidance.

Francesco Pesole

CEE: Good times for the region

With the new month, the CEE region is growing busier again, with several inflation prints and central bank meetings this week.

Today, September inflation will be released in the Czech Republic, where we expect only a slight pick-up from 2.5% to 2.6%, which would be in line with the Czech National Bank's forecast. Tomorrow, we will see industrial production data for August in Hungary and the Czech Republic.

On Wednesday, the National Bank of Poland will decide on rates, and our economists expect no change at 4.75%, in line with surveys. However, market pricing and surveys suggest a close call and some chance of another 25bp rate cut. The National Bank of Romania also meets on Wednesday, but this should be a non-event with rates unchanged at 6.50%. We'll also see September inflation in Hungary, where we expect a small pickup from 4.3% to 4.4%, in line with market expectations. On Friday, Romania will publish its final GDP figures for the second quarter.

CEE FX had another good week with gains across the board, and conditions remain positive for the region. Central banks are still hawkish, and although we may see a rate cut from the NBP this week, hawkish forward guidance can be expected due to fiscal policy. However, EUR/PLN has already seen some rebound from the upper end of our 4.240-275 range last week, and the market seems to be preparing for a hawkish scenario regardless of the rate decision.

EUR/RON jumped above 5.090 for a moment on Friday and continues its upward trend. The central bank seems willing to tolerate greater flexibility than it has shown previously, and the market is pushing the pair higher. Still, we should not see a move closer to or above 5.010, and we expect higher activity from the central bank in the market in an effort to prevent additional inflationary pressures.

Chris Turner

CZK: Change of government but limited change in fiscal policy

Saturday's general election in the Czech Republic brought results roughly in line with pre-election polls, and the country is now heading for a change of government. The main opposition party, ANO, surprised with an increase in support, but it is not enough for a one-party or two-party coalition. Therefore, there are two options on the table – a minority government with the support of some parties, or a coalition with the SPD and Motorists, which will be revealed in negotiations in the coming days.

Markets may see it as positive news that parties openly calling for withdrawal from the EU/NATO did not make it into parliament, or underperformed expectations, which takes this issue off the table. At the same time, no party has enough votes to push its agenda, and the new parliament will have to seek consensus on new legislation.

As we mentioned before the elections, we consider the market's fiscal concerns to be exaggerated. It is difficult to say whether the market will see relief from this result or, on the contrary, if it reinforces concerns in the short term – but we continue to believe that the medium-term politics will show that there is no visible turnaround in fiscal policy.

We therefore remain bullish on the Czech koruna and, after the sell-off in recent weeks, on CZK fixed income at the long end of the curve. We still believe that the Czech elections are more about monetary policy and the Czech National Bank's response than fiscal policy, which is positive for FX.

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