FX Daily: Prices back in the driving seat

Rising prices and what central banks plan to do about them should be back in the spotlight this week. In focus will be Wednesday's release of US October CPI, where inflation could be pressing close to 6% YoY. And today we'll hear from the Fed's Richard Clarida at 15CET. With energy prices on the rise again, continue to favour the dollar and energy-exporting FX.

Dollar can hold gains into Wednesday's US CPI release

A strong October NFP released on Friday helped trade-weighted measures of the dollar retest the highs of the year, but as yet there has been no major upside breakout. As we have said previously on these pages, we suspect that if the dollar is to break to new highs this year it will probably have to happen this month since seasonal trends area against the dollar in December.

Yet that upside breakout is still possible since this week we will very much return to the subject of inflation and what central bankers plan to do about it. Wednesday sees the release of October US CPI - seen pushing to a new cyclical high near 5.8/5.9% YoY. This comes at a time when the Atlanta Fed GDPNow measure forecasts the economy growing at 8.5%. And now that the Fed has started tapering, the debate naturally moves onto the timing of the first Fed hike and the scale of the tightening cycle. Look out for a speech from Fed-centrist Richard Clarida at 15CET today speaking on the subject of monetary policy. We have heard a few Fed hawks questioning the need for patience when it comes to tightening, but similar remarks from centrists like Clarida would certainly send US short-term rates and the dollar higher.

Today also sees energy prices back in the headlines. Brent continues to trade near $84/bl after OPEC+ ignored pleas for sharper increases in supply last week. And European gas prices could grab the headlines early today too. Despite suggestions that it would start filling European natural gas containers today, Russian gas deliveries and bookings so far remain very low. A month ago a surge in gas prices helped drive central bank re-pricing stories. Another surge today should continue to help NOK and RUB.

We favour DXY staying bid in a 94.00-94.50 range into Wednesday's US CPI release.

EUR: ECB sticks to the script

EUR/USD held above key support at 1.1500 on Friday - a level that will certainly be a tough nut to crack this year. Yet as above, we would favour EUR/USD staying offered in a 1.1520-1.1620 range this week and see whether US CPI or any Fed speakers provide enough ammunition for a downside breakout.

On the Eurozone side, today sees November Sentix investor confidence ahead of tomorrow's ZEW readings - these are second-tier data. We will also hear from ECB speakers, Makhlouf and Lane. Makhlouf has sounded more hawkish recently, but Chief Economist Lane has been firmly sticking to the script that inflation is transitory and responding to it with tighter policy would be a mistake. Look out for more comments from Lane today at 1410CET at an ECB event on money markets.

Elsewhere, CEE FX has been doing better. EUR/CZK traded down to a new low for the year at 25.18 - following Thursday's 125bp rate hike from the CNB. We would expect EUR/CZK to stay offered and focus to increase on the CNB's large (EUR140bn) FX reserves and whether to start selling them in order that CZK strength plays a greater role in tightening monetary conditions. We'll also see the NBP release its inflation report today - our team see Polish inflation pushing up to 7% YoY around year-end. And Romania is expected to hike 50bp or more tomorrow. The National Bank of Romania views portfolio capital in the region as 'fluid' and keeps close watch of how high Romanian rates are versus peers in the region.

GBP: Back to Brexit

After the shock of unchanged BoE rates last Thursday, GBP is staying gently offered. In focus now is tension between the UK and the EU over the border in the Irish Sea and what seems to be the UK's plans to hit the reset button by triggering the Article 16 protocol. Press reports suggest this may happen by the end of November. This issue has been bubbling since the summer but has failed to hit GBP too severely. And we suspect that GBP can hold up ok, assuming that the prospect of a BoE rate hike in December remains live.

It is not a view held with much conviction, but we prefer not to chase EUR/GBP higher and see 0.8600 as the potential top of a range into year-end. We think EUR/GBP ends the year somewhere closer to 0.8500.

ILS: Different path

A good example of what a mixed year it has been for global FX markets is USD/ILS. The dollar was broadly weak in January and the Bank of Israel (BoI)announced a $30bn intervention programme to resist Shekel strength. Broad measures of the dollar are now on the highs for the year, yet the BoI has now spent $30bn in FX intervention and USD/ILS is on its low for the year.

Driving the Shekel is a very strong 5%+ of GDP current account surplus, helped by its tech industry. Though it has used up its $30bn intervention bucket, we very much doubt the BoI will completely step away from USD/ILS - it is a very interventionist central bank. Yet a brief run sub 3.10 cannot be ruled out. The ILS is also seen as somewhat of a safe haven in the EM world, backed by a strong sovereign balance sheet. ILS out-performance on the crosses should continue.

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