FX Daily: Rate rises starting to hurt

Today's focus will be the October US CPI release which will have implications for Fed policy, risk assets and the dollar. News from Canada that a mortgage investment fund is suspending redemptions could also be a first signal of the cross-over from higher interest rates to financial stability risk. We would continue to favour the dollar

USD: What has core inflation got to say?

At last month's FOMC meeting, Federal Reserve Chair Jay Powell concluded the press conference with a sense of frustration that inflation had not fallen more quickly. Inflation data understandably is now one of the biggest market movers of the month and today sees the US October CPI release. Headline inflation is expected to dip to 7.9% from 8.2% year-on-year, but the market's focus will be on the core rate - i.e. what is happening to underlying prices outside of food and energy. Here, the market will be looking at the core monthly figure - expected at 0.5% after two months at 0.6% month-on-month.

Our US economist, James Knightley, favours a 0.5% core MoM figure, with the range of analyst expectations stretching from 0.3% to 0.6%. James says medical costs have been generating upside pressure of late, but that pressure could start to ebb. Elsewhere, core goods prices are being lowered by falling freight costs, the strong dollar, and weakening demand, while used car prices should fall and anecdotal evidence of rent declines is spreading. However, as Chair Powell noted last month, the point when rents start dragging down core CPI may be some time off.

Today's release will have some bearing on what the market prices for the Fed meeting on 14 December, where a 56bp rate increase is currently priced. The CPI data will not be the final say on that decision (we have jobs data and another CPI release before then), but it can set the tone regarding the Fed's comfort level. Expect the dollar and the positively correlated bond and equity markets to trade off today's data - where any upside surprise could do some damage to the recent benign risk environment and end the recent correction in the dollar.

Separately, an item catching our attention was that a Canadian fund, the Rompsen Mortgage Investment Fund, had halted redemptions since 'loan payoff activity remains suppressed'. The real estate sector is on the front line when it comes to aggressive rate increases and we wonder whether investors will view this as one of the first casualties and a possible cross-over from macro risk (recession) to financial stability risk. Let's see how the Canadian dollar deals with the news today and whether any pressure builds on those currencies normally associated with stretched housing markets, which beyond Canada are normally seen as those in Scandinavia.

DXY to trade 109.50-110.50 range, with a slight upside bias.

Chris Turner

EUR: Rangebound

EUR/USD continues to drift towards the upper end of recent ranges. As above, the US inflation data will be a key driver. Despite the recent recovery in equities, the external environment is still mixed, including lockdowns spreading across China. For today, the eurozone data calendar is light and we have a few European Central Bank speakers at an event at 14CET. The market is currently split on whether the ECB hikes 50bp or 75bp at the 15 December meeting. Our team favours 50bp.

Today's US data is big enough to put an end to the recent EUR/USD correction - should inflation surprise on the upside.

Chris Turner

GBP: House prices starting to feel the crunch

Earlier today we saw the RICS house price balance data for October. UK estate agents now see house prices declining for the first time since the summer of 2020 - a clear response to the recent surge in mortgage rates. This will again question the market's pricing of the Bank of England's tightening cycle, where we think rates priced at 4.65% next summer are way too high.

Sterling saw a big intra-day sell-off yesterday - which looked more flow than macro-driven. 1.1150 is a clear target for GBP/USD were the dollar to strengthen today. Again, we doubt any gains over 1.15 endure.

Chris Turner

CEE: Czech inflation to test CNB new forecast

Today, we will see inflation data for October in the Czech Republic. We expect a further rise from 18.0% to 18.2% YoY. However, the main issue, as in recent months, is energy prices and since

October the impact of government measures on CPI. The unclear approach of the statistical office is reflected in the extremely wide range of surveys from 17.2% to 19.0% YoY. The Czech National Bank expects a decline to 17.4% YoY. However, it is clear that we can expect surprises on both sides. We believe the CNB has a solid buffer for upside surprises and any market bets on additional central bank rate hikes would be short-lived. The Czech koruna has been moving to stronger levels since the November meeting and briefly touched its strongest levels since the beginning of February. Higher inflation should again support the interest rate differential and keep the koruna at its current strong levels.

Later today, National Bank of Poland Governor Adam Glapinski is set to speak in a press conference after the Bank left the policy rate unchanged at 6.75% yesterday, against the consensus of a 25 basis point hike. The central bank's new forecast brought lower economic growth and also higher inflation, especially next year. The post-meeting statement indicates that the NBP targets a reversal of the inflation trend and wants to facilitate a soft landing for the economy rather than bring inflation down to 2.5% as quickly as possible. Today we will hear more details of the governor's view and what we can expect next from the NBP. As we mentioned earlier, we see the zloty as vulnerable and just yesterday it lost 0.9% against the euro. We expect it to continue to trade above 4.75 EUR/PLN today.

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