

FX Daily: RBA's cautious tightening continues

The Reserve Bank of Australia hiked by another 25bp and we expect 50bp of further tightening in 2023 to reach a 3.60% peak rate. Implications for AUD are limited, however, and we see downside risks as Chinese sentiment falters. Markets are back to pricing in a 5.00% peak Fed rate, which is helping the USD recover. EUR/USD may stabilise before another leg lower



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➔ USD: Recovery mode

The risk-on wave generated by easing Covid restrictions in China did not extend beyond Asian stock markets yesterday, and risk assets were mostly weaker after a surprise rise in US ISM service cast doubts on dovish Fed bets, and Fed Funds futures are once again pricing in a 5.00% peak rate in 2023. Risk sentiment has remained fragile this morning.

The dollar has recovered some ground, mostly against the Japanese yen (which is the most sensitive to the Fed factor) and some high-beta currencies. We think USD/JPY could climb back above 140.00 in the run-up to the Federal Open Market Committee (FOMC) meeting next week, as markets take stock of strong jobs data and weigh a more hawkish outcome than previously

expected. Elsewhere, USD/CNY is climbing back to the key 7.00 level, and we expect a break higher sooner than later.

We discussed yesterday how the dollar had fallen back to a neutral position versus G10 currencies. This means that a further drop in the dollar will need to see investors make a conviction call on an extended dollar bear trend as the room for long-squeezing has now shrunk significantly. We think such a call would be premature and expect a dollar recovery into year-end.

Today, the US calendar is very light (only the trade balance for October to highlight) and there are no Fed speakers due to the pre-FOMC blackout period. We could see reduced FX volatility today, and the dollar may cement recent gains.

Francesco Pesole

➔ EUR: Downside risks prevail

EUR/USD has not moved dramatically compared to other G10 crosses despite the dollar rebound. The pair could hover around 1.0450/1.0500 today, but is mostly facing downside risks in our view.

The freshly imposed EU embargo on Russian seaborne crude and the \$60 per barrel price cap may start to show their effects on the energy market soon. When adding an expected drop in temperatures in Europe from this week, the risks of a new rally in energy prices are non-negligible, and the euro is highly exposed to such risks.

There are no major data releases to flag in the eurozone today and no scheduled ECB speakers.

Francesco Pesole

⬇️ AUD: Another 25bp hike by the RBA

The Reserve Bank of Australia (RBA) hiked rates by another 25bp to 3.10% this morning. Since the RBA has policy meetings approximately every month, it can continue to hold a very straightforward meeting-by-meeting, data-dependent approach, and there was unsurprisingly very little forward guidance in today's statement except for the vague reference to more tightening ahead.

We currently forecast the RBA peak rate at 3.60%, and a 25bp rate hike at the next meeting (7 February). Tomorrow morning, Australian GDP figures for the third quarter will be released and should show strong growth (consensus 6.3% year-on-year). However, jobs and CPI releases later this month and in January will be more important for the RBA.

AUD/USD reaction to the RBA hike was positive but quite contained, and the pair remains strictly tied to global risk dynamics and especially market sentiment on China. It does appear that optimism related to easier Covid restrictions in China is quickly evaporating, and AUD may soon end at the bottom of the G10 scorecard. We target 0.66 for both year-end and the first quarter of 2023.

Francesco Pesole



CEE: Another delay in EU-Hungary story

The EU-Hungary story changes every day. The agenda for today's Ecofin meeting was changed at the last minute and it seems that today there will only be a discussion on the subject but no vote. This confirms earlier speculation that the lack of time between the publication of the European Commission's recommendations and today's Ecofin meeting would require an extraordinary meeting later. Last week the EC recommended to the EU Council to suspend 65% of the EU funds on three operating programmes for 2021-27 for Hungary, amounting to €7.5bn. Regarding the recovery funds, the EC approved Hungary's recovery plan but said that actual disbursement of the funds will take place only after Hungary met 27 "super milestones" by the end of the first quarter of next year.

So what is the schedule for the coming days? We are likely to hear new headlines today that will give us guidance on what to expect next Monday, when an additional Ecofin meeting is due to take place, and on Thursday and Friday next week, when the last European Council meeting for this year is scheduled, which should be the final deadline of this story.

On the FX side, in the CEE region, the weaker euro against the US dollar was probably the main reason behind the weakness, but still, the Hungarian forint led yesterday's losses. Presumably, another investor lost patience given another delay of a decision in this story. However, the turnaround in sentiment in global markets does not imply a favourable week for the region. Only retail sales in Romania and the Czech Republic are on the calendar today, but the focus will once again be on the Hungarian forint and the Polish zloty.

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