FX Daily: Reeves keeps sterling afloat

The pound has welcomed yesterday's UK Budget announcement, as improved fiscal headroom is seemingly not coming at a hefty price for growth. Still, a Bank of England cut in December is still on the table. Expect thinner liquidity into the weekend, with the dollar potentially stabilising after this week's correction

The pound rallied after yesterday's UK Budget

USD: Stability after correction

As discussed yesterday, we believe this week's dollar correction has more to do with a convergence towards lower rates following the dovish Fed's repricing, rather than any geopolitically driven rotation away from safe havens. The outperformance of the yen relative to a high-beta European currency like SEK is a clear testament to that.

US markets are closed for Thanksgiving and liquidity conditions should be considerably thinner. That could be an attractive environment for Japanese authorities to intervene in USD/JPY. However, there may still be a preference to intervene after a USD-negative data event, and the stall in the pair may have removed some sense of urgency.

The dollar remains somewhat expensive against G10 currencies, but given the size of this week's correction and limited room for further dovish repricing before some more data comes in, we are switching to a neutral bias on USD for this Thanksgiving holiday.

Francesco Pesole

EUR: Upside potential remains

The euro retains some upward potential if a peace deal in Ukraine is agreed. The latest indications are that while some progress is being made, negotiations may drag on into next week.

For now, EUR/USD bulls like us should be content with the return to 1.16. We think 1.17 can be reached with the pair's short-term undervaluation being trimmed, and our 1.18 year-end target with seasonal factors and some soft US data in December.

Today, the ECB publishes the minutes of its 30 October rate decision. We don't expect it to be a meaningful release for markets, as the Governing Council's neutral view has been widely confirmed in post-meeting speeches.

Francesco Pesole

GBP: Sterling welcomes the Budget

Sterling rallied on the budget yesterday. The positives came in the form of higher fiscal headroom (less pressure on fiscal credibility) plus the fact that the UK government did not need to raise taxes as much as expected next year. Helping the latter point was the Office for Budget Responsibility's reassessment of the current fiscal hole at a mere £6bn.

Concerns over the credibility of back-loaded tax hikes may have to be left to another day. And we do not think the government's spending plans, running into a 2029 election, look credible. Equally, we do not think sterling has to rally too far now, either. Our take is that this Budget does not have major implications for the BoE cycle, but at the margin, lower energy prices could give the BoE a little more confidence to cut.

With sterling not particularly cheap on a trade-weighted basis, we still think three BoE cuts over the next seven months could send EUR/GBP a little higher. As such, we expect EUR/GBP to meet demand in the 0.8700/8750 area and work its way back to 0.8850 ahead of a BoE rate cut on 18 December.

Chris Turner

CZK: Lower energy prices should push the market in a dovish direction

Negotiations on the new government after the October election are still underway in the background, which has taken a back seat to the markets' attention. The appointment of the government itself is being postponed, but the base scenario should remain unchanged, and the new government will be appointed in December.

More interesting, however, are the discussions on the state budget for next year. Yesterday, the parliament decided to return the budget draft to the government for changes, where, according to the new majority, revenues do not cover expenses. Therefore, the new majority demands that the government propose primarily new cuts in expenses or increase the deficit if there is no other way. This also suggests that the Czech Republic will have a provisional budget in January due to delays

in negotiations. Still, we believe that the budget will not change much compared to the plan of the outgoing government (2.3-2.5% of GDP in our estimate) and the discussions are rather an echo of the election campaign.

More interesting for the markets will be the early opening of discussions on the new government's plan to subsidise part of the regulated component of energy prices for households and companies. This should shave about 0.3-0.5pp off headline inflation, depending on the final parameters. Together with lower energy market prices and the postponement of ETS2 from 2027 to 2028, the entire CNB inflation forecast could shift down by an average of 0.5pp over the next two years. While we do not expect the CNB to return to rate cuts as a result, the market has shifted hawkish in recent weeks. We believe that a lower inflation profile should return market pricing from one rate hike in the 1.5-year horizon to no change or a smaller chance of a rate cut.

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