FX Daily: Sprinting back to defense

Despite a goal-rich start at the World Cup in Qatar, markets are all about defense right now. New Covid restrictions in China are fuelling a return to the safe-haven dollar while investors wait for tomorrow's FOMC minutes. This may be laying the groundwork for a broader USD recovery into year-end. Elsewhere, we expect a 50bp rate hike by the RBNZ

USD: Recovery mode

China's Covid situation has suddenly returned as a very central driver for global markets this week. Over 27,000 cases were reported today, with the city of Guangzhou being the new epicentre of the outbreak, and local authorities are reportedly scrambling to impose those same restrictive measures that appeared a thing of the past after recent signals from the central government that the zero-Covid policy would be gradually abandoned.

In FX, this has fuelled a return to the dollar. After all, optimism on China's outlook was one of the two key forces - along with speculation about a dovish pivot by the Fed – behind the sharp dollar correction earlier this month. On the Fed side, tomorrow's minutes will be important to watch, but the recent Fedspeak has undoubtedly added a layer of caution to the dovish pivot enthusiasm, which could mean investors may also be more reluctant to overinterpret dovish signals from the minutes. We have a few speakers to monitor today amid a very light data calendar in the US: Loretta Mester, James Bullard (both hawks) and Esther George (more neutral).

Another theme to watch today will be the reported OPEC+ plans to increase output. The news caused an acceleration in the crude sell-off yesterday, with Brent trading below $85/bbl before recovering after the Saudis denied the reports. Should output hike speculation mount again, expect some pain for commodity currencies, as the combination with resurging Covid restrictions in China could prove quite toxic.

We continue to see the dollar at risk of new brief bearish waves this week, but we note that the environment has now turned more benign for the greenback, and this may be laying the groundwork for a re-appreciation into year-end, which is our baseline scenario. We could see some consolidation around 107.50/108.00 in DXY today. Remember that liquidity will run significantly thinner in the second half of the week as the US enters the Thanksgiving holiday period.

Francesco Pesole

EUR: Preparing for a longer downtrend

EUR/USD plunged back to the 1.0250 area as markets jumped back into defensive dollar trades yesterday. Indeed, the negative impact of China's new Covid wave on the rather exposed eurozone economy and of an ever-concerning situation in Ukraine are overshadowing the positives of lower energy prices. We see further room for a contraction in EUR/USD this winter and continue to target sub-parity levels into the new year, as discussed in our 2023 FX Outlook.

The eurozone calendar includes consumer confidence data (which is expected to have marginally recovered) and speeches by the European Central Bank's Robert Holzmann, Olli Rehn and Joachim Nagel. Expect some support at 1.0200 in EUR/USD: a decisive break below that level could underpin the return to a bullish dollar narrative and unlock more downside risks.

Francesco Pesole

NZD: We expect a 50bp hike by the RBNZ

The Reserve Bank of New Zealand will announce monetary policy at 0100 GMT tomorrow, and it is a close call between a 50bp and a 75bp hike. As discussed in our meeting preview, we see 50bp as more likely, as signs of an accelerating housing market contraction warn against an overly aggressive approach. Markets (66bp in the price) and the majority of economists are, however, leaning in favour of a 75bp move.

New rate and economic projections will also be released, and there are some key questions to be answered. The first of these is where the RBNZ will place the peak rate, which is currently at an unrealistic 4.10% (rates are at 3.50% now), so should be revised to 5.0% or higher, and how many cuts will be included in the profile. The second is how much more pain will be included in the forecasts for the housing market. Third is how fast inflation is projected to drop given the higher CPI readings for 3Q but more aggressive tightening.

A half-point hike would likely be seen as a dovish surprise by markets at this point, but a significant revision higher in rate projections could mitigate any negative impact on the New Zealand dollar. Either way, expect any post-meeting NZD moves to be short-lived, as global risk dynamics and China news will soon be back in the driver's seat for the currency. NZD/USD is at risk of falling back below 0.60 before the end of this year, while we target a gradual recovery to 0.64 throughout the whole of 2023.

Francesco Pesole

CEE: EU disputes turn the spotlight from Hungary's central bank

Today is the busiest day in CEE this week. In the morning we start with the monthly indicators in Poland. The main focus will be industrial production for October, as a leading indicator for the rest of the region. Polish industrial production is benefiting from an improvement in supply chain functioning, which supports export-oriented industries, including automotive and electrical products. We expect only a slight slowdown from 9.8% to 8.8% year-on-year, above market expectations. Labour market numbers should confirm the still tight conditions with wage growth of 13.8% YoY. PPI will confirm continued price pressures in the economy with the YoY number accelerating from 0.2% to 1.1% in October.

From a market perspective, today's numbers may be perceived as having implications for the National Bank of Poland's economic outlook and monetary policy. After all, it is wage growth that has been the biggest surprise to the central bank's forecast in the past. Thus, today's numbers may revive market hopes for an additional rate hike and support the zloty in the short term. However, we remain bearish in the medium term with a forecast of 4.90 EUR/PLN at the end of this year.

Later today we will see the National Bank of Hungary (NBH) meeting. We do not expect any fireworks at this rate-setting meeting. The latest data regarding inflation and GDP were broadly in line with the central bank's expectations and the next staff projection update is only due in December. Against this backdrop, we don't see any game-changing moves. When it comes to the risk environment, we haven't seen a material improvement in domestic or external risk factors, which were flagged by the central bank as triggers to consider changes in its monetary stance.

The Hungarian forint has been hovering in the 400-415 EUR/HUF range for the past few weeks, far from the NBH's pain threshold. The market is pausing in place, awaiting news from the Hungarian government's negotiations with the European Commission. These could theoretically come today, which would overlay today's NBH meeting. However, from last week's hints, it is likely that we will hear more bad news before any good news comes, which may cause further volatility in the FX market. However, a happy ending to this saga should see the forint below 400 EUR/HUF in our view.

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