

FX Daily: Stars aligning for a dollar recovery?

Markets are keeping an eye on developments in China with some concern as they prepare for two key risk events – Jerome Powell's speech tomorrow and payrolls on Friday – which look more likely to push rate expectations higher rather than endorsing dovish speculation. When adding the very inverted US yield curve, a dollar recovery may be on the cards this week



Markets are bracing for tomorrow's speech by Fed Chair Jerome Powell, where he is expected to sound hawkish

USD: Bracing for a hawkish Powell

Risk assets underperformed at the start of this week, with two major variables affecting global sentiment. First, social unrest in China. Investors appear to be gravitating towards the risk-negative narrative of possible instability in the country, despite the fact that this may prompt China to expedite its exit from Covid restrictions – likely a risk-on development.

The second element relates to concerns that this week's events, which include tomorrow's speech by Fed Chair Jerome Powell (where we see a higher likelihood that he will sound hawkish) and US jobs data (which could stay strong), may cause the Fed's communicated and perceived narrative to drift away from dovish pivot expectations. As mentioned in yesterday's daily, a 2Y10Y UST curve

displaying a 75/80bp inversion is indicating a common perception that the Fed will push forward with tightening into a recession. This should be a dollar-positive combination.

Today's US calendar includes some housing data as well as the Conference Board Consumer Confidence Index, which is expected to have dropped further in November. There are no scheduled Fed speakers after hawkish comments by John Williams and James Bullard yesterday.

We believe the dollar can find some further support today as markets favour defensive trades ahead of key events later this week. Prior to Powell's speech, a return to 107.00/107.50 levels in DXY is possible.

Francesco Pesole

EUR: Few signs of abating inflation

EUR/USD failed to break the 1.0500 threshold yesterday and has dropped back to the 1.0350/1.0400 area after a widespread recovery in the dollar. The eurozone's exposure to China is one key driver to watch for the euro, and it could easily outweigh the benefits of lower energy prices.

Today, however, the domestic story will receive a lot of attention. Inflation readings in Germany and Spain will provide hints about eurozone-wide data due tomorrow. The consensus is for German headline inflation to stabilise at 10.4% and eurozone figures to slow slightly tomorrow. It's difficult to see this significantly altering the ECB's narrative, but an above-consensus print may prompt markets to seriously consider a 75bp hike in December (61bp are currently priced).

Still, hawkish ECB expectations have not often translated into a stronger euro, and we continue to see the dollar doing the heavy lifting in driving EUR/USD moves. At this point, we believe a drop below 1.0300 is more likely than a rebound to 1.0500.

Elsewhere in Europe, Sweden's GDP numbers have just been published, disappointing on the downside with 2.5% year-on-year growth for the third quarter. Retail sales for October also came in weaker. The next Riksbank meeting is far out (early February), but a softening in data could favour a 25bp hike after last week's 75bp move. We expect EUR/SEK to end the year around 10.85/10.95.

GDP figures will also be released in Switzerland this morning, and a deceleration to 1.0% YoY in growth is expected for 3Q.

Francesco Pesole

GBP: Bailey's testimony in focus

Today's UK calendar is light on data, but there is one event to keep an eye on: Bank of England Governor Andre Bailey's testimony to the House of Lords. A significant shift in Bailey's policy rhetoric two weeks before the BoE meeting appears unlikely, but the proximity to the meeting also means that markets tend to over-interpret MPC members' comments. In our opinion, the most likely scenario for the December announcement is a 50bp increase; markets are currently pricing in 57bp.

Cable has fallen back below 1.2000 as the dollar regained some ground, and we see room for

further depreciation into the end of the year as the greenback finds more support and the pound suffers from a bleak UK economic outlook.

Francesco Pesole

📉 CAD: Growth figures should allow 50bp hike next week

As the dollar corrected lower during the past month, the Canadian dollar has lagged behind its G10 counterparts. The decline in crude prices, which have returned to the trading range observed before Russia's invasion of Ukraine, has been the main factor holding back the loonie's recovery.

Our commodities team continues to see the upside risks for oil prices into the new year, and CAD's limited exposure to China/Ukraine and superior liquidity are good arguments to expect CAD to outperform other procyclical currencies in 2023, should risk sentiment stabilise.

Today, Canada's third-quarter growth data will be published, and expectations are for a 1.5% annualised read. This should enable the Bank of Canada to hike by 50bp next week.

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