# FX Daily: Sterling's big day

Today's FX highlight will be the UK's autumn statement. Given that the UK's bond market has largely regained its composure from the sell-off in September, we struggle to see what upside there is for sterling today. Positioning could be the wild card, however. Elsewhere, we have five Fed speakers and favour further dollar consolidation

## USD: Softer renminbi helps support the dollar

Yesterday, we published our 2023 FX Outlook and for professional customers our FX Top Trade ideas. Our core message for FX markets in 2023 is to expect fewer FX trends - i.e. a repeat of a clean 18-month dollar trend is unlikely - and instead look for more volatility as central banks tighten rates into a recession. Feedback on the report is welcome!

For today, the dollar has entered a consolidative mode. We note the rise in USD/CNH which may be giving the dollar a little support. Somewhat conversely, the better news out of China seems to be giving the local banks some problems. Here, retail investors have en masse withdrawn from Chinese bond markets in favour of equities, prompting authorities to check with local banks whether they have sufficient liquidity to meet these withdrawals.

For today, we have five Fed speakers. Market pricing for the 14 December FOMC meeting is settling on a 50bp hike - such that any further reference to that today need not demand a much weaker dollar. Our slight bias near term is that long dollar position adjustment may have a little further to run, but that something like the 105 area in DXY proves a 4Q22 base.

*Chris Turner*

## EUR: Could be dragged around by sterling

EUR/USD remains in corrective mode and is not reacting much to press reports of the European Central Bank favouring a 50bp over a 75bp hike in December. Notably, the FX options market has shown no more signs of distress - i.e. investors are not scrambling to buy euro call options - and one can argue that this makes the 1.05 area a slightly firmer ceiling for 4Q22.

Expect EUR/USD to be dragged around by GBP/USD today - just as it was in September. 1.0270-1.0500 remains our expected near-term trading range for EUR/USD.

*Chris Turner*

## GBP: Caution advised

The big day has arrived. Chancellor Jeremy Hunt will unveil the autumn statement aimed at plugging the fiscal hole that led to the collapse of Gilts and sterling in September. Investor views of UK fiscal credibility have largely returned to pre-Truss levels, where the 10-year German Bund-Gilt spread is now 115bp (versus 228bp in September) and the UK's 5-year sovereign CDS has narrowed to 27bp from 52bp. Arguably then, the positive re-assessment of the UK fiscal position has largely taken place and suggests that sterling does not have to rally a lot more on a credible budget.

Indeed, a credible budget will deliver substantial fiscal tightening and cement views of a multi-quarter UK recession and one in which the Bank of England will continue to hike rates into 2023. As a pro-cyclical currency, this cannot be a good environment for sterling. And were Chancellor Hunt to try and back-load fiscal tightening - e.g. until after the next election in 2024 - Gilts and sterling would sell off. Overall, we expect GBP/USD to be unable to hold any gains above 1.20 and would prefer sub 1.15 levels before year-end. Equally, EUR/GBP should find support near 0.86/87.

The only thing going for sterling is buy-side positioning. Being short the pound had been one of the most popular buy-side trades going into October. We have seen what positioning has done to crowded long dollar trades over the last week. It is hard to see what sterling positives the market could take from today's budget - but there is an outside risk that investors have some residual sterling shorts to cover. The outside risk near term is a very painful sterling short-squeeze taking GBP/USD to 1.23. However, that squeeze should not last long.

*Chris Turner*

## BRL: Reality check

It seems fair to say that the Brazilian real has disappointed some of the more bullish expectations made when Luiz Lula won the Presidential election run-off in October. Investors had been attracted to the real because of Brazil's high real interest rates and the idea that a centrist congress could keep some of President-elect Lula's spending plans in check.

However, concerns about Brazil's fiscal position and welfare spending plans have come back to the fore. The new administration, taking office in January is looking at a constitutional amendment to exclude around $30bn of welfare spending from the nation's fiscal debt limit. Reuters is also reporting that Lula may be favouring a left-wing choice for Finance Minister - typically a very sensitive topic for Latam currencies. Equally, further choices for Lula's new team are said to be coming from the administration of former left-wing President, Dilma Rousseff, who was widely associated with Brazil's last fiscal crisis.

We have been more bearish on the Brazilian real than consensus for some time and in our recently published FX Outlook, we make the case for USD/BRL to be ending 2023 much closer to the 5.80 highs than the consensus estimate of 5.15. Investors looking for yield in Latam should instead continue to favour the less volatile and better fiscally positioned Mexican peso. And near term, BRL/MXN can trade back to the 3.50 lows.

*Chris Turner*

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