

FX Daily: This isn't a mini-budget rerun for sterling

Sterling and gilts took a hit yesterday, but we don't think the content of the UK budget and market conditions mean the pound will re-experience the kind of turmoil from the 2022 mini-budget. In the US, payrolls are seen declining, but markets will consider carefully the effect of severe weather events, and the dollar may still find support into Election Day



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📉 USD: Assessing the hurricane effect on payrolls

The US releases jobs data for October today. Consensus is centred on a slowdown in nonfarm payrolls to 100k and unemployment unchanged at 4.1%. Our economist call is in line with consensus at 100k, although he sees unemployment ticking higher to 4.2%. If we are right with our call today, we expect a slightly negative impact on the dollar, as some of the strength associated with the previous jobs report is priced out and markets may push the Fed pricing back to 50bp of easing by year-end.

That said, we doubt the dollar is due a large correction so close to the US election, and there is also a risk markets (and the Fed) will give a reduced weight to a softer payrolls numbers given the

temporary hit to jobs from the latest severe weather events. The unemployment rate should, however, be less affected by those events, and that can have longer-lasting market implications.

The greenback rally has lost some steam this week against the euro due to stronger than expected [eurozone data](#), but has remained generally bid against the high-beta currencies that are more exposed to Trump hedges. We cannot exclude that those hedges are increased once the payroll risk event is cleared, and some broad-based deleveraging ahead of a highly-binary US election for markets causes the kind of worsening in FX liquidity conditions that leads to a further rotation into dollars.

The US calendar also includes the ISM manufacturing, which is expected to inch higher from 47.2 to 47.6. The employment component is expected to have improved marginally too, and that may attract a bit more interest.

Francesco Pesole

➔ EUR: Looking pricey

Eurozone flash inflation estimates for October showed a re-acceleration to 2.0%, which is understandably favouring a repricing to the hawkish side in the EUR curve. The OIS market now prices in 58bp of easing by the European Central Bank over December and January, with the chances of a half-size move in December now having been scaled back to just 22%.

There are no ECB speakers until Monday and today is a holiday in some eurozone markets, meaning potentially slightly reduced action in the euro markets.

EUR/USD is starting to look a bit expensive in the upper half of the 1.08-1.09 range, and barring a US jobs data-induced push today, we favour some depreciation in the pair into US Election Day, with a move back to 1.0800 as being completely in line with a wide rate differential in favour of USD.

Francesco Pesole

➔ GBP: Not buying the sterling demise narrative

The market's digestion of Wednesday's UK budget has now gone through a number of phases. The initial benign reaction gave way to a bearish run in gilts and sterling, which intensified yesterday. At the time of writing, sterling is enjoying some stability, and 10-year gilts closed at 4.45% yesterday after having peaked at 4.53%.

There are a few considerations to be made about the sterling market at the moment, the main one being that this is not a rerun of the post 2022 mini-budget market turmoil. While borrowing is set to rise substantially – and likely more than what the gilt market had priced in – tax rises mean fears of unfunded spending are kept in check. Incidentally, UK pension funds' LDIs are nowhere close to the leverage levels of 2022, when calls led to snowball panic gilt selling.

Rather than a panic selloff, yesterday's sterling-gilt drop looked more like a “repricing” led by higher inflation/Bank of England rate expectations, as well as a mechanical adjustment to increased borrowing. This mechanical adjustment could have longer to run as investors finalise their assessment of the gilt market's ability to absorb the additional supply, and the actual extent that tax raises will be able to cover for additional spending. However, market conditions point to a

gradual shift to structurally higher yields rather than disorderly spikes.

This is the “bad” kind of rise in yields, from a sterling perspective. However, we suspect some of sterling’s drop was due to some positioning squeeze (remember GBP was the largest speculative long in G10 last week), and an extended severe depreciation would require a disorderly gilt selloff, which is not our base case. Our view is that sterling can drop a bit further as the readjustment to higher bond supply runs its course, but with GBP short-term swap rates having received a lift from the BoE repricing (only one cut expected in 2024 now), rate differentials can soon offer a floor to the pound. We stick with our recent call that cable will be close to 1.28 on US Election Day.

Francesco Pesole

📌 CEE: Poland and Hungary closed for public holiday

The end of the week in the region should be quiet. The Polish and Hungarian markets are closed today and activity should be muted. On the calendar we have PMIs across the region with the exception of Poland. These could show some improvement after the data in Germany. In the Czech Republic, the budget result for October will be released which should indicate the first costs associated with the floods.

In the markets, the Czech koruna showed some outperformance yesterday within the region while the Hungarian forint remains under pressure. EUR/HUF almost touched 410 yesterday but returned to 408. There still seems to be no room for stabilisation here in the near term and we expect CEE to remain under pressure at least until the US election. Further direction will depend on the outcome of the election. Therefore, EUR/HUF is likely to continue to test new highs. EUR/CZK bounced down from 25.40 and the koruna reaffirms its resistance within the region, which remains our preference for the days ahead.

Frantisek Taborsky

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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