

FX Daily: Too early for a move above 1.10

EUR/USD is eyeing the key 1.10 level, but we suspect that any breaks above that level will prove unsustainable as the rates picture remains broadly supportive for the dollar until the US growth picture turns decisively negative. We keep favouring a dollar comeback in the near term. In New Zealand, the RBNZ may deliver a hawkish hold



A quiet day for the eurozone calendar features a few ECB speakers, but the impact of remarks made so far on the euro has been rather muted, and EUR/USD should remain almost solely a function of USD moves and Fed rate expectations

➔ USD: Excessive weakness

The dollar has stayed under pressure at the start of this week as markets remained bullish on Treasuries across the curve on the back of growing dovish Federal Reserve expectations. The Fed Funds future curve currently prices in the first rate cut in June 2024. Yesterday, soft US home sales data helped consolidate the dollar's bearish momentum and now endorses the narrative that higher rates are having a more tangible impact on the economy.

Expect the dollar to remain very sensitive to US data, including today's Conference Board Consumer Confidence index, which is expected to have mildly declined. We'll also take a look at the Richmond Fed manufacturing index today. On the Fed side, there are a number of speakers to monitor: Austan Goolsbee, Christopher Waller, Michelle Bowman and Michael Barr. The central bank will almost surely keep rates on hold in December, but the softening in its hawkish stance in November was due to the tightening of financial conditions – and the recent drop in rates significantly increases the chances of pushbacks against rates cut speculations, which can help the

dollar rebound.

Month-end flows may get in the mix and delay a dollar recovery, but we remain of the view that it is too early to chase the dollar bear trend. There is still some resilience in US data into year-end that can prop up the high-yielding dollar.

Francesco Pesole

➔ EUR: PEPP discussions kick off

ECB President Christine Lagarde fuelled expectations that the central bank will reshape its bond reinvestment strategy soon yesterday during her EU Parliament hearing. The current indications by the ECB are that its pandemic emergency purchase programme (PEPP) will be in the reinvestment phase until the end of 2024, but there has been growing pressure inside the Governing Council to accelerate quantitative tightening.

Tighter financial conditions are generally positive for a currency, but this specific discussion around PEPP reinvestment could have unwelcome spillover into the euro area peripheral spreads. The Italian BTP-bund 10-year spread is more than 25bp below the 200bp pain threshold, but 2024 carries risks for Italian bonds as EU fiscal rules are reinstated and the economy slows. We currently identify Italian bond spreads as one key risk for the euro next year, even if it is not our base case that they will sustainably widen to concerning levels.

Today, the eurozone calendar is quiet, but there are few ECB speakers to watch. Lagarde will deliver a pre-recorded message, and Pablo Hernández de Cos, Joachim Nagel and Philip Lane are also scheduled to speak. The impact on the euro of ECB members' remarks has been rather muted and EUR/USD should remain almost solely a function of USD moves and Fed rate expectations. We are not convinced the pair has enough backing on the rates side to trade sustainably above 1.10 and favour instead a correction below 1.0900 in the coming days.

Francesco Pesole

➔ GBP: Bearish momentum in EUR/GBP may not last

We had called for a break below 0.8700 in EUR/GBP as sterling benefitted from the better risk environment more than the euro, and above all, the fiscal support in the UK was a clear-cut GBP-positive. We suspect the pair may be reaching the bottom of its recent downtrend, as risk sentiment may start to soften into key US data and the UK fiscal event's impact on markets wears off.

We expect increasing support for the pair around 0.8650 and at the 0.8640 100-day MA. When it comes to Cable, our view is very similar to that of EUR/USD; the probability of a correction from these levels appears rather high.

The UK calendar is empty today, but we'll hear from the Bank of England's Jonathan Haskel this afternoon. Yesterday, Governor Andrew Bailey pushed back against rate cuts while acknowledging the encouraging news on inflation.

Francesco Pesole

📈 NZD: RBNZ may focus on pushing back against rate cuts

The Reserve Bank of New Zealand (RBNZ) announces monetary policy overnight and will almost certainly keep rates on hold again. Since the October meeting, inflation, employment and wage growth have all slowed more than expected. Still, the Bank has to operate with the most lagging inflation data (only quarterly) in the G10 space and will probably focus on keeping its stance broadly hawkish against rising rate cut speculations.

Markets currently price in a first rate cut in New Zealand around this summer, while current rate projections by the RBNZ (published in August) signal rates will be kept at the 5.50% peak at least until the end of 2024. We think the Bank will try to discourage further rate cut expectations by signalling rates will be held at 5.50% or cut only by 25bp in the whole of 2024.

That can help NZD get some further support, although the very good performance of the Kiwi dollar of late remains almost solely a function of external factors. Domestically, it's worth keeping an eye on the expected change in the RBNZ remit by the newly installed government, which plans to remove the dual mandate to focus on inflation only. In our view, that is a long-term NZD-positive.

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