

FX Daily: Two big risk events this week

The dollar long squeeze on Friday was likely triggered by optimism on China's Covid rules. We suspect this is too premature, and macro factors continue to point to dollar strength. But there are two key risk events for the dollar this week: US CPI (we expect a 0.5% MoM core reading) and mid-term elections (Biden losing control of Congress may be a USD negative)



➔ USD: Room for recovery, but watch for the mid-terms

Last week was a hectic one in FX. Fed Chair Jerome Powell's hawkish press conference left markets searching for an even higher peak rate (currently at 5.1%) and highlighted the divergence between the still hawkish Fed and the growing list of developed central banks that are turning more cautious on tightening (Bank of England, Bank of Canada, Reserve Bank of Australia, Norges Bank). This was a clear bullish narrative for the dollar, which was well supported until Friday when optimism in risk assets triggered some heavy position-squaring on dollar longs.

A key risk-on driver on Friday was the apparent loosening of Covid restrictions in China. Indeed, China's economic woes have been a major factor weighing on global sentiment in recent months. However, a larger relief rally appears a bit premature. First, because the course of Beijing's health policy has been very hard to interpret, and Chinese officials have already pushed back against any

speculation they will drop the zero-Covid policy. Second, this morning's drop in Chinese exports is yet another signal that slowing global demand is a major drag on Chinese growth. Third, China has been only one factor in the negative risk equation: the search for a higher Fed peak rate and elevated uncertainty around the medium-term economic outlook and energy crisis should keep a cap on risk assets for longer – and ultimately may still favour defensive trades like long dollar positions.

The dollar correction that started in late October was fully unwound in about a week, and this indicated – in our view – how macro factors continue to favour dollar strength and the corrections are mostly related to position-squeezing events. We, therefore, expect a re-appreciation of the dollar in the near term, although there are two major risk events to watch this week in the US: the CPI report and mid-term elections.

Our US economist expects inflation numbers this week to be important, but not critical for future policy action by the Fed. Most of the focus will be on the monthly change in core CPI, which we expect to come in at 0.5%, in line with consensus. That would indicate further resilience in underlying price pressures and may prevent markets from completely discarding another 75bp hike in December, ultimately offering the dollar a floor. Below-consensus readings may force a dovish re-pricing in rate expectations though.

When it comes to the US mid-term elections, we discussed the scenarios and market implications [in this article](#). The bigger downside risk for the dollar is that the Republicans secure control of both the House and the Senate, which would imply a hamstrung administration unable to deliver fiscal support in a downturn. A split Congress (House control going to the Republicans) may be mostly priced in, and the implications for the dollar could be relatively limited.

We expect more FX volatility this week, but retain a near-term bullish USD bias and expect DXY to climb back above 113.00 in the coming weeks. Today's calendar in the US only includes speeches by Fed's Loretta Mester and Tom Barkin.

Francesco Pesole

➔ EUR: China's push looks premature

Europe's elevated exposure to the China growth story means that the euro should benefit from speculation that Beijing will loosen Covid restrictions. As discussed in the USD section above, this appears premature speculation, and Chinese growth is still facing the grim prospect of slowing global demand. In line with our view that the dollar should recover in the near term, we don't think EUR/USD will be able to climb back above parity on a sustainable basis – even though the two risk events this week (US CPI and mid-term elections) could trigger another USD long squeeze.

There are not many key data releases in the eurozone this week, and most focus will be on European Central Bank speakers. A pre-registered video of Christine Lagarde on the digital euro will be released this morning, and we'll hear from Fabio Panetta later today. There are a plethora of other speakers during the week, but the direct impact of expected ECB policy on the euro looks set to remain rather contained.

Francesco Pesole

➔ GBP: In an uneasy position

Despite the dollar's correction on Friday, the pound still has to fully recover from the post-Bank of England blow. Indeed, the combination of a highly concerning economic outlook and a forced dovish repricing in rate expectations look set to keep the pound rather unattractive.

This week, 3Q growth figures are the highlight in the UK calendar, and our economist forecasts a 0.5% quarter-on-quarter contraction, which should all but endorse the BoE's more cautious approach. There are a few MPC members speaking this week, including Chief Economist Huw Pill and Silvana Tenreyro, the latter having voted for a 25bp hike last Thursday.

Cable may be primarily driven by dollar moves this week, but EUR/GBP could extend gains to the 0.8850/70 area.

Francesco Pesole

➔ CEE: Local story replaces global factors

We have another heavy week [ahead](#) in the Central and Eastern European region. Today, we start with industrial production in the Czech Republic, where PMIs show a steep decline in production at the end of the year. Tomorrow, in addition to retail sales and industrial production in Hungary, we will see the [Romanian central bank's last meeting](#) of the year. We expect a slowdown in the tightening pace to 50bp to 6.75%, in line with market expectations, which could be the last hike in this cycle. But an additional 25bp hike cannot be ruled out in January. Hungarian inflation for October will be published on Wednesday. We expect another jump from 20.1% to 21.0% YoY. Also, on Wednesday we will see the Polish central bank meeting. Our call is for a 25bp hike to 7.00%, but no change will also be on the table, in our view. Thursday will see the release of October inflation in the Czech Republic. We expect only a slight increase from 18.0% to 18.2% YoY, slightly above market expectations, but the risk is new government measures and the approach of the statistical office. Then on Friday, we will finish the series of October inflation prints in Romania, where we expect a slowdown from 15.9% to 15.2% YoY, slightly below market expectations.

In the FX market, surprisingly for us, CEE has survived tough weeks which have seen ECB and Fed rate hikes, a stronger dollar and gas prices at higher levels. This week, the local story will come into play. EUR/USD and gas prices are back to more CEE FX-friendly levels, which should be positive for the region in the first half of the week.

On the other hand, interest rate differentials are still pointing to weaker FX in the region, and central bank decisions and CPI readings (except in Hungary) support a rather dovish mood, which is negative for FX. From this perspective, we see the Polish zloty as most vulnerable at the moment, which should suffer from the central bank's dovish decision. Moreover, the cost of funding has fallen from its peak in recent days, making shorting less expensive. Thus, we see the zloty closer to 4.750 EUR/PLN in the second half of the week. The Hungarian forint shows the biggest gap in our models at the moment against a weaker interest rate differential. However, higher inflation should again support market expectations and hold the forint slightly above 400 EUR/HUF. The Czech koruna reached its strongest levels since August after the [Czech National Bank meeting](#) and is benefiting from temporary short position liquidation. However, we see its value rather closer to 24.50 EUR/CZK. The Romanian leu is down from NBR intervention levels and is closely following global sentiment. Therefore, we expect it to remain below 4.90 EUR/RON for longer.

Frantisek Taborsky

Authors

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

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.