

FX Daily: Just a short-term correction for the USD

The negative USD story remains intact and we look for a multi-quarter bearish dollar trend, with the latest USD rebound being a short-term correction, rather than the start of a new trend



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USD: Just a short-term correction in the dollar

The rout in equity markets and the sharp sell-off in tech stocks yesterday reversed some of the past gains in pro-cyclical currencies and temporarily helped USD, yet FX markets have already shown signs of stability overnight, with the USD rebound pausing. Some form of correction in stock markets does not come as a surprise, following their multi-month sharp rise as well as concerns about the lofty valuations, but given the Fed's willingness to ease more (should it be necessary - with stock markets' price action likely being a consideration) as well as the uninspiring USD outlook (where the Fed's shift to average inflation targeting points to a prolonged period of low USD nominal and real rates), we don't expect a long-lasting negative spillover into FX markets.

The negative USD story remains intact and we look for a multi-quarter bearish dollar trend, with the latest USD rebound being a short-term correction, rather than a new trend.

Today, the focus is on the US labour market report. Our economists look for a below-consensus NFP and an unchanged unemployment rate. With the current nervousness in the market, softer US numbers may modestly weigh on risk and further help the dollar today.

➔ EUR: Limited upside limited at least until the next ECB meeting

Should the US labour market report disappoint today and weigh on risk appetite, EUR/USD is likely to re-test the 1.1800 support level but 1.1750 should still hold.

Near-term, the EUR/USD upside is limited at least until the ECB meeting next Thursday.

⬇️ GBP: More challenging weeks ahead

GBP/USD followed the correction lower in higher beta currencies, with the downtrend mainly led by the falling EUR/USD.

With the near-term EUR/USD upside limited (at least until the ECB meeting next Thursday) and the expected return of negative headline news around the UK-EU trade negotiations, GBP/USD is unlikely to move towards the psychological 1.35 level this month.

⬇️ CEE FX: Struggling across the board with HUF no longer underperforming

CEE FX has been hit by the mix of the reversal in risk appetite and lower EUR/USD.

While a weaker, HUF no longer underperforms its CEE peers due, in part, to positioning as investors already built larger shorts in HUF (vs CZK and PLN) over recent weeks following the upside surprise to Hungarian CPI.

We expect neither of the three free-floating CEE currencies to heavily underperform/ outperform the region in the current fragile environment, but currently softer EUR/USD (though we don't expect this to be long-lived given the strong bearish USD story) makes the currencies more vulnerable vs their EM peers at this point.

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