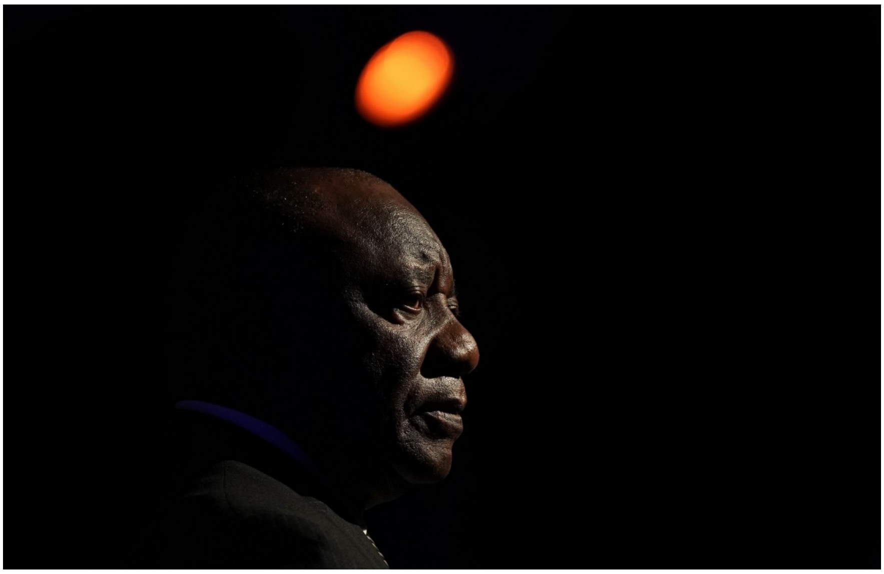
FX Daily: Wake up call for dormant FX market

FX markets have been becalmed over the last two weeks as participants tidy up positions for year-end and await the next key input into the global macro stay. One such input will be received today in the form of the US November CPI release, where another soft 0.3% MoM core reading is expected. It's a big release and will set the tone for tomorrow's FOMC meeting



A scandal involving South African President Cyril Ramaphosa is driving the rand underperformance

USD: November CPI front and centre

Traded levels of volatility for longer tenors (one month and three months) have been falling sharply over the last two weeks as the FX markets take a breather. Even though shorter-dated tenors price in plenty of volatility over the next week, the view seems to be that into the first quarter of next year, FX markets can continue to settle. That view will be challenged over the next 36 hours with the release of the November US CPI at 1430CET today and the Federal Open Market Committee (FOMC) tomorrow at 20CET.

Given that last month's CPI release was a major trigger for the dollar sell-off, all eyes will be on today's figure. Our chief international economist, James Knightley, is forecasting the key core component at 0.3% month-on-month, the same as the consensus and the same as last month.

James says the upside risk stems from shelter and Owners' equivalent rent not falling as quickly as consensus expects – it takes time for the decline in asking rents to feed into what is actually being paid. And downside risks come from used car prices again and whether medical costs stay soft after their technical fall last month. James says there will be more focus today on "services ex shelter" inflation, given that Fed Chair Jerome Powell highlighted that in a recent speech.

Today's release will set the dollar tone for tomorrow's FOMC meeting and into the first quarter of 2023. We think the market is being a little early in pricing 50bp of rate cuts for 2H23 and could see the dollar bouncing on any upside surprise in today's CPI data – including upward revisions to last month's reading. The data probably will not be a knock-out blow to the dollar – one way or the other – given tomorrow's big FOMC meeting including a new set of Dot Plots.

Therefore plenty to play for over the next 36 hours. A DXY close above its 200-day moving average at 105.80 would be helpful in supporting our view that the dollar will be strengthening through 1Q23.

Chris Turner

EUR: Make or break

As above, CPI and FOMC inputs into the dollar equation will be a key driver of EUR/USD into year-end and early 1Q23. If we were to pick out two levels, we would say the 1.0600/10610 area is key resistance. A close above that on a soft US CPI release would warn of a lot more pain into year-end and EUR/USD drifting up to 1.08 and even 1.0950/1.1000. On the downside, the 200-day moving average is now 1.0350 and would be a level any investors trapped long dollars at higher levels might choose to offload some dollars.

Away from EUR/USD, the EUR/HUF cross rate continues its volatile path. News from Brussels last night is that there appears to be progress on the release of EU funds to Hungary. Investors have been here before with many false dawns, but it does indeed seem like progress is being made. As we discuss in our recently released Directional Economics, the Polish zloty, not the Hungarian forint, will probably be the market's target for scrutiny in 2023.

Chris Turner

GBP: Better jobs data gives the BoE a headache

We have just seen the latest UK jobs data, where the November payroll increased more than double what was expected and the weekly earnings rate ex-bonus nudged up to 6.1% 3m/YoY, the highest in a year. This adds to thoughts of a full employment recession and supports some of the more hawkish pricing of the Bank of England (BoE) policy cycle. It is probably not enough to prompt the BoE into another 75bp hike on Thursday (a 57bp hike is priced) but will support sterling.

Today's UK data could light the fuse of a Cable rally, were US CPI data to oblige. Our prior has been that this rally stalls around this 1.2300/2310 area – but a close above here warns of another three to four big figures higher during thin, year-end markets.

Chris Turner

ZAR: President Ramaphosa faces proxy impeachment vote

One might have expected the South African rand to be doing a little better over recent weeks. The dollar is weaker, the China re-opening narrative has prompted a rally in the industrial metals markets and seen South Africa's terms of trade improve markedly. But no, outside of the Russian rouble, the rand is the worst EMEA FX performer since 10 November – the release date of the soft US October CPI data.

Driving that rand underperformance seems to be politics. President Cyril Ramaphosa has been caught up in a scandal, whereby an independent panel has concluded he might have violated the constitution in the way he handled the investigation into the theft of cash at his property. The findings of that panel will today be put to a vote in the South African parliament – seen as a proxy impeachment vote for Ramaphosa. The question is how many disgruntled members of the ruling African National Congress (ANC) party will join with the opposition in supporting the panel's finding.

As above, we would have thought the rand would be trading a lot stronger were it not for this vote. But equally, if the vote goes through, USD/ZAR could easily be trading over 18.00 in thin December markets. In short, current levels near 17.50 may not last for long.

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