FX: Senate serves up a tax reform curveball

Why we expect the dollar to slide further and our outlook for other major currency pairs

USD: Reflation sentiment dented as Senate serves up a Tax Bill curveball

The US tax reform saga continues to dominate the USD narrative, with the latest twist being the release of the Senate's own version of the House's 'Tax Cuts and Jobs Act'. In a nutshell, the Senate has pretty much taken out any of politically contentious tax policies – with the corporate tax rate cut to 20% delayed till 2019 (as opposed to the House's intent for instant enforcement).

Moreover, Senators remain wary that drastic changes still need to be made in order to adhere to their more stricter fiscal rules, such that the tax bill can be voted through with a simple majority. With the Congress week-long Thanksgiving recess starting next Friday, the odds of a GOP tax plan landing on President Trump's desk this side of Xmas remain slim-to-none. A growing realisation of this will see the $ slide even lower.

EUR: Greater risks for a move above 1.17 as the $ rally loses steam

The ECB's November economic bulletin did shed light on the thinking underpinning the central bank's QE taper policy, with officials explicitly noting that the EUR plays a key role in the policy reaction function. As long as EUR/$ continues to trade this side of 1.20, we doubt the single currency will be a big concern for the ECB. There is certainly scope for further upside in the near-term as the USD rally runs out of steam; a move above 1.1680/90 would be supportive of a corrective move higher.

In Norway, the fairly subdued CPI data (headline: 1.2% YoY; core: 1.1%) supports the case for a dovish Norges Bank and EUR/NOK staying above 9.45.

GBP: Near-term turbulence to continue given next week's UK data splurge

It has been another politically-driven rollercoaster ride for GBP this week, albeit one that has proved to be anti-climactic for our medium-term constructive view. Indeed, the link between resignations and reshuffles within PM May's Cabinet – and the short-term political risks that need to be priced into GBP – is somewhat tenuous. Yet, if the key to unlocking major further gains in UK asset prices is still progress in Brexit negotiations, then one can only expect the ongoing turbulence in GBP markets to continue.

Next week's UK data splurge – which includes the latest CPI, jobs, wage growth and retail sales releases – is unlikely to be game-changing for the BoE's policy outlook, although some positive surprises may see sentiment for a second rate hike resurface. The same can be said for today's UK industrial production data (0930 GMT). While it is understandable that the MPC are reluctant to show their policy hand amid this crucial period of Brexit talks, we do think the dovish repricing of BoE policy expectations within markets has been a tad excessive. A steeper UK curve should drive GBP/USD back up to the 1.34- 1.36 area – or at the very least keep the pound supported above the 1.30 level.

RON: Today's NBR FX fixing the key for a potential further decline

A rise in Romanian CPI (2.6% YoY vs 2.2% consensus) underlines our view for strong inflation dynamics in the coming months. Following the significant decline in RON against EUR since the National Bank of Romania meeting (where we noted that the Governor signalled a shift from mild inflation targeting with a managed floating FX regime to fully-fledged inflation targeting), the focus will be on the NBR EUR/RON fixing. Should we see yet another rise in fixing (above EUR/RON 4.6300), then a break of the psychological 4.65 level is likely. A high pass-through from FX to inflation means that we expect the NBR to eventually tame the pace of the RON decline.

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