FX Daily: Looking for ‘cockroaches’

As Jamie Dimon warned, there may be more ‘cockroaches’ (i.e. distressed lenders) out there after two US regional banks reported credit issues last week. Markets will be looking very closely for evidence of that, and the dollar continues to face substantial downside risks. Later this week, US CPI should not come in hot enough to derail Fed easing plans

USD: Still downside risks

Concerns about the health of regional banks and the broader quality of credit in the US remain very central for FX markets. On Friday, some recovery in sentiment helped the dollar rebound, signalling that going forward, some harder evidence backing those concerns is probably required to pressure the dollar again. That will be looked for in this week's regional lenders' earnings releases. Here, risks appear tilted on the downside for the dollar.

Indications that lending issues don’t extend beyond Zions Bancorp and Western Alliance could offer some further relief to the dollar, but it might not be enough to fully price out concerns about the underlying health of the credit market and have the greenback reclaim all losses. On the contrary, evidence of contagion to other lenders or signals of larger credit quality issues can easily send DXY falling 1%+ in the next few days.

On Friday, the BLS will publish the delayed CPI numbers for September. We are aligned with consensus in expecting a 0.3% MoM core read – which should further endorse a 25bp cut by the Fed next week. Barring major deviations from consensus, the inflation release should not have major FX implications, with jobs markets playing a more important role for rate expectations.

Francesco Pesole

EUR: At fair value

The eurozone calendar is empty until Friday's PMI and EUR/USD moves will primarily depend on market sentiment about the US credit market. What is important to note is that EUR/USD is spot on its short-term fair value (1.167) despite the recent rally. That is partly because the starting point of a week ago was one of moderate undervaluation, but also because US lending condition fears go hand in hand with dovish repricing in Fed expectations. The EUR:USD two-year swap rate gap tightened sharply to 104bp before re-widening to 110bp after Friday's risk re-rating. But it remains some 4-5bp tighter than a week ago and 7-8bp tighter than the start of October.

The calm on the French political side allowed the euro to recover a bit, but it's hard to get too comfortable with France. S&P downgraded the country from AA- to A+ in an unscheduled move on Friday, despite a draft budget providing for a deficit reduction having been released. As discussed here, the decision to freeze the pension reform complicates budgetary decisions ahead, even if it allows a temporary political reprieve. And the budget discussions are set to intensify in the coming days and weeks. Given the fragility of the government, it remains too early to price out the French effect from the euro fully.

But this week the focus should stay on the US, and a further souring of credit sentiment could send EUR/USD on a path to 1.180.

Francesco Pesole

GBP: Room to soften vs EUR

Our economics team expects Wednesday's UK services inflation to undershoot the BoE's projection with a 4.6% read, which is also below the 4.8% consensus. That can modestly move the needle to the dovish side in the GBP swap curve and weigh on the pound this week.

Incidentally, expect a steady flow of information about the content of the November budget in the coming weeks. That appears like a double-edged sword for sterling. Any concerns about fiscal sustainability will hit back-end gilts and spill over into the pound, while higher taxation should dampen growth and raise chances of earlier BoE easing.

We retain a bullish bias on EUR/GBP, and see risks skewed to 0.88 into the budget event risk.

Francesco Pesole

CEE: Local and global story provides more room for rally

This week, central bank meetings and geopolitics are in focus. Today, wage data, industrial production, and PPI will be published in Poland. While calendar effects and a low comparison base provide a good foundation for industrial production, foreign developments point in the opposite direction.

On Tuesday, the National Bank of Hungary is expected to keep its rates unchanged at 6.50%. More interesting will be the forward guidance, given the weak economy and renewed calls from the government for lower rates. However, hawkish pushback from the central bank can be expected, as headlines in recent days have indicated. On Wednesday, we should see strong retail sales in Poland continuing their recovery.

On Thursday, the Central Bank of Turkey will continue its cutting cycle, where we expect a slowdown to 150bp after inflation surprised to the upside in September. Therefore, the risk is also for a smaller or no rate cut.

Outside the calendar, we will also be watching a possible meeting between the American and Russian presidents in Budapest, announced last week, which could bring some progress in the Ukraine-Russia conflict and have an impact on the CEE region. Here we see HUF and PLN as the biggest potential beneficiaries in a possible market reaction, with the market already confirming this bias on Friday. On top of that, we are approaching the blackout period of the Czech National Bank, and this week we might see the first interviews.

As we discussed here on Friday, CEE FX has a good constellation of conditions for further rally with a potential boost from a Ukraine-Russia ceasefire. At the same time, EUR/USD has bounced upward, and local rates have stabilised after a rapid rally. We are therefore bullish on the CEE region this week, where hawkish stances from NBH and CNB could add to the momentum. In detail, however, EUR/PLN has reached the bottom of its usual range, and the room here is limited. On the other hand, EUR/HUF could return to 388 and EUR/CZK to 24.250.

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