FX Daily: Fighting the Czech National Bank is futile

The Fed successfully announced tapering with barely a ripple in global asset markets. We are pleased to see the dollar holding gains against the low-yielders and expect US data to keep the dollar bid. Central banks are back in the spotlight today, where both the BoE and the CNB should hike rates and Norges Bank should remain on track for a hike next month.

USD: Let the data do the talking

The Fed has managed to successfully announce tapering with barely a ripple in global asset markets. That could have triggered a decent sell-off in the dollar as investors rushed back to carry trades. The fact that the dollar continues to trade near its recent highs against EUR and JPY should be a reminder that: (a) EUR and JPY look better funding currencies than the dollar and (b) that the Fed has fired the starting gun on policy normalization, eventually tighter dollar liquidity, higher US rates and what should be a stronger dollar.

With tapering out of the way , six weeks until the next FOMC meetings and fresh Dot Plot projections (these have been a big driver of the dollar this year) the focus will very much be on US data. Here the US October ISM data has been strong and the story of how pent-up demand releases itself over coming months and quarters should be a positive one for the dollar.

The US calendar is quiet ahead of jobs data tomorrow, but the dollar could today enjoy some further modest gains against the oil exporters as Brent remains under pressure on this week's crude inventory builds, the restart of the Iran nuclear talks and the OPEC+ meeting later today.

DXY should continue to find support below 94.00.

EUR: ECB tightening expectations recede

The ECB is having some success in taking the steam out of 2022 tightening expectations. The EUR 1Y1Y OIS is off nearly 20bp from last week's highs and it looks as though the doves are regaining some control. There are a few ECB speakers today, but overall we would expect EUR/USD to remain quiet ahead of tomorrow's jobs data. 1.1575-1.1625 could be today's narrow range.

Elsewhere, yesterday saw the National Bank of Poland surprise with a 75bp rate hike. EUR/PLN understandably sold off on the surprise, but then rallied when NBP Governor Glapinski mentioned that it could still intervene in the FX market to weaken the Zloty. That seems an untenable policy mix - tightening PLN liquidity through rate hikes on the one hand, while loosening it with FX intervention on the other. 4.57-4.63 may prove the near term EUR/PLN range as the market seeks clarity here.

In Norway, the Norges Bank will announce monetary policy this morning at 0900 GMT. As discussed in our meeting preview, we see very little scope for surprises, with the NB likely to reiterate their plan to hike again in December, as higher oil prices are underpinning domestic recovery. We think markets will see little reasons to review their pricing of four hikes by end-2022, which is also our base-case scenario. NOK is fully embedding the higher rate expectations, and we see limited scope for the currency to benefit from more hawkish re-pricing, and its attractive carry may play out as a positive only in the longer run. EUR/NOK is currently undervalued by around 2% according to our short-term fair value model, and we see the risks for an upside correction in November, although we still target 9.70 for the end of December.

GBP: Slight downside risks on BoE day

It's BoE day. GBP has corrected a little this week already and we suspect that it may have a little further to go should it appear that Governor Bailey does not carry at least 8 of the nine member MPC with him in voting for a 15bp rate hike. Please see our full preview here.

0.8535 is the risk on EUR/GBP today. Yet a BoE hike well before the Fed does tee up GBP for further gains over coming months as UK inflation pressures continue to build. Our team does not see UK inflation peaking until next April at around 4.5/5.0%.

CZK: Fighting the CNB is futile

In a world where dovish central banks are being bounced out of untenable policies, the CNB is sitting pretty. As one of the most hawkish central banks around, it set the tone for large increment rate hikes with a 75bp tightening in September. And another 75bp is widely expected today - taking the policy two-week repo rate to 2.25%. A large, front-loaded tightening cycle is now priced in the Czech Republic. 3 x 6-month Forward Rate agreements expect 3m Pribor close to 3.50% early next year. This pricing has exploded from just 2.20% a little over a month ago.

At times like these most ask whether the CNB can possibly deliver on this aggressive tightening? And in most cases, the answer is yes. Beyond the rate adjustment today, the market will be focusing on a new set of CNB forecasts. The last set of releases were made in August and saw 3m Pribor at 2.15% in 1Q23. 3m Pribor is already trading above that! Expect some chunky upward revision to the inflation profile, which in August saw inflation peaking around 3.7% in 1Q22. Growth numbers will be cut significantly this year on the pandemic and auto shutdowns. Let's see what the CNB thinks about growth for next year.

EUR/CZK is trading higher than the CNB had envisaged in August, begging the question of whether it needs to adjust for this by tightening rates even more aggressively? We do not think the CNB will be shy about discussing taking policy rates back above the 3% area seen in 2008 - i.e. well above the 2.25% pre-pandemic peak. 3m implied yields now give the CZK a 2.3% per annum carry pick-up over the EUR - and this may widen further. Given it looks like CZK longs suffered a partial clear-out late last month, we would favour the ever-hawkish CNB to drive EUR/CZK back to the 25.35 area.

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