

## FX Daily: A dollar rally to start the New Year

The dollar jumped yesterday as investors started to return from the long Christmas break. Markets are unwinding some dovish bets, and questioning stretched equity valuations, ultimately favouring defensive bets in FX. The dollar also tends to seasonally outperform at the start of the year. Today, the focus moves back to data, as well as the FOMC minutes



Source: Shutterstock

### USD: Dollar seasonally strong in January and February

Defensive bets dominated in global markets as investors returned from the long Christmas break. This was particularly evident in the FX market, as the dollar corrected sharply higher yesterday to the detriment of European currencies. The tendency of dollar selling and European FX buying that emerged in December was triggered by the dovish pivot at the December FOMC, but seasonal factors also played a role. The dollar tends to underperform at the end of the year, likely due to some tax-related flows from US corporations: DXY weakened in December in each of the past seven years. While the seasonality factor isn't as strong, January tends to be a good month for the dollar, with DXY having risen on average 0.4% in the past 20 years. February has shown a stronger

positive seasonality pattern, with DXY having appreciated in each of the past seven years.

The dollar strength in the early part of the year is often associated with the December tax flows by US corporates being reverted, and while expectations of a firmer dollar at the start of the year (which we agree with) could have exacerbated yesterday's USD buying, the key factor remains Federal Reserve dovish bets against the backdrop of stretched equity valuations after a strong year for US stocks, in particular in the tech sector.

We have observed some tentative unwinding of dovish bets as trading resumed: interestingly, the Fed Funds futures curve no longer fully prices in a March cut (21bp at the moment). As trading volumes pick back up this week, US calendar events will also offer direction to investors. Today, the Fed releases the minutes of the December FOMC, which should shed some light on the reasoning behind the dovish revision of the Dot Plot. Given the strong dovish reception by the market after the December Fed announcement, there is a risk of the minutes preventing further dovish bets as some conditionality (in terms of economic data developments) for easing policy emerges in the minutes.

Today also sees the release of JOLTS job openings for November and the December ISM manufacturing, and consensus is positioned for a good print in both releases. We are inclined to think that the dollar can hold on to most of yesterday's gains in the next couple of days, as data may prove benign and investors favour defensive positions ahead of Friday's US payrolls – which are expected to print a respectable 170k. DXY may hover around the 102 gauge into the payrolls. Beyond the very short term, we still expect a further dollar decline to materialise this year as the deterioration in the economic outlook forces large Fed cuts, but the pace of USD depreciation should be more moderate in 1H24 compared to November/December 2023.

*Francesco Pesole*

## 📉 EUR: A well-justified correction

EUR/USD performed quite strongly during the holiday period, touching 1.11 on 27 December. The post-correction levels around 1.0950 are, however, more in line with the short-term rate differential. We must remember that the rise in Fed dovish bets was matched by European Central Bank rate cut speculation, and the diverging narratives expressed at the respective December monetary policy meetings did not really change the short-term rate picture.

The EUR-USD 2-year swap rate gap remains around 125bp, close to the lows for 2023. EUR/USD detached from its short-term rate dynamics in November/December, as dovish Fed bets fuelled a big rally in equities and the risk-on environment had an asymmetrical impact on the pro-cyclical EUR. However, dwindling risk sentiment definitely puts EUR/USD at risk of reconnecting with its depressed short-term rate differential, especially considering domestic economic news in the eurozone has remained rather grim. We think EUR/USD continues to face downside risks, and a return above 1.10 appears less likely than a decline to the 1.08 region. This week, the focus will be on inflation numbers for December: France and Germany's numbers are released tomorrow, with the eurozone figures on Friday.

EUR/GBP climbed back close to the 0.8700 mark in late December, and while we still expect a capitulation of the Bank of England's higher-for-longer narrative to hit the pound this year, the short-term outlook remains rosier for GBP than for the euro. A return to 0.8600 is possible before a clearer appreciating trend emerges.

*Francesco Pesole*

## ➔ CHF: SNB FX policy to hit the franc

One of the strongest G10 FX performers over the festive period has been the Swiss franc. This has been a surprise to us and many in the market. At the last Swiss National Bank policy meeting (14 December), the SNB told us that it was no longer focusing on FX sales as part of its monetary policy toolkit. That may have been a recent change of mind for the central bank, however, given that in 3Q23, it had still sold CHF37bn of FX (data released 29 December).

With the SNB now predicting inflation to be within range over the forecast horizon and having adopted a balanced risk assessment on inflation too, we doubt the SNB will be too happy with the 3% appreciation in the trade-weighted Swiss franc since its December meeting. We suspect the Bank is more likely to be an FX buyer than seller now and could easily see the SNB helping to nudge EUR/CHF back to the 0.95 area this month.

*Francesco Pesole*

## ➔ CEE: The market is losing patience with PLN

Yesterday's PMIs in the CEE region confirmed continued weakness in industry in December, especially in the Czech Republic where the leading indicator fell to its lowest reading since September last year, sinking hopes of a recovery at the end of the year. The calendar is empty in the region today, but it should get more interesting in the days ahead. On Thursday, the Czech Republic will release the state budget result for last year. The Ministry of Finance is already indicating that the resulting deficit could be lower than projected (CZK295bn), which would be good news for Czech government bonds (CZGBs). At the same time, MinFin is expected to publish a funding plan for this year by the end of this week, the last one in the CEE region, which we believe should also point to a positive picture for CZGBs this year. Then, on Friday, the final 3Q GDP report in the Czech Republic will be published, while in Poland, December inflation will be released. We expect a small increase from 6.6% to 6.7% year-on-year, slightly above market expectations. However, the wide range of estimates suggests an interesting print here.

In the FX market, most of the region started the year with gains except the Polish zloty. The general picture for the CEE region seems mixed with a stronger US dollar on the one hand and higher market rates across the board on the other. Although PLN should benefit the most from higher rates across the region in our view, it is the weakest since November last year. Heavy long positioning and just a lazy move down in EUR/PLN in recent weeks seems to have triggered some selling in PLN. Yesterday's paying flow in the rates market seems to have stopped the sell-off around 4.360 EUR/PLN, however, it is hard to say if we are at the end for now. We still expect a stronger PLN given the macro and monetary policy outlook, however for now we will have to experience a moment of weakness. Elsewhere in the region, higher market rates seem to have supported FX and CZK and HUF are enjoying new gains. In Hungary in particular, we could see more in this direction over the coming days, in our view.

*Frantisek Taborsky*

## Authors

### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.