

## FX Daily: A higher bar for a lower dollar?

March may not give us conclusive answers on US inflation, the economy or on when the Fed will cut, but it will tell us whether markets now require sharper US data declines to re-enter easing bets. The dollar may still struggle to find clear direction in March, but we expect USD bearish pressure to intensify from the second quarter



### ➔ USD: Dovish asymmetry in rate expectations may not last

US PCE figures - released yesterday - confirmed what most had expected: inflation stayed too hot in January. However, as discussed by our US economist [here](#), there are still hopes that the disinflationary process will resume in time for a June rate cut by the Federal Reserve. Personal income and spending figures came in strong too, but real household disposable income did not grow at all in January. We must remember how crucial this is to fuel real consumer spending now that excess savings have almost entirely run down: with the spending push likely to ease, inflation should come down more steadily.

From a market perspective, the notion of resilient US inflation and activity data has now been fully digested. Investors are comfortable with three 25bp cuts priced in by December as there is just not enough data evidence to turn more dovish now. Similarly, a rate cut before June seems unlikely. All this is translating into a resilient dollar, with EUR/USD trading at 1.0800, which looks fair to us given market conditions.

US data is not set to lose any of its centrality for markets in the new month: expectations are probably that we will start seeing some softening in February's data, starting with payrolls. But while we have recently observed a dovish asymmetry in rate expectations, the bond reality check

in February may have set the bar a bit higher (“lower”, from a US data perspective) for a new round of enthusiastic easing bets. Our view remains that 2Q is when US data will prove soft enough to take the dollar lower, and we see a US dollar decline only accelerate decisively in the summer.

Today, the ISM manufacturing index will be in focus. There is a risk that it hits the 50.0 mark (or above) for the first time since October 2022, which can reinforce expectations of an extra-resilient economic environment in 1Q. Given the index has been in contraction for a very long time, downside surprises may not have the same impact as a rebound to 50+. So, there are some upside risks for the dollar today, although data in the eurozone can also play a role in price action before the weekend. All in all, we stand by our call for DXY to end the week above 104.0.

On the Fed side, there are many FOMC members speaking today: John Williams, Thomas Barkin, Christopher Waller, Lorie Logan, Raphael Bostic, Mary Daly and Adriana Kugler. Comments on policy and the latest inflation figures are therefore quite likely.

*Francesco Pesole*

## ➔ EUR: Faster disinflation not enough for cuts

Yesterday, CPI declined slower than expected in France (from 3.1% to 2.9%) and faster than expected in Germany (from 2.9% to 2.5%). Our colleague Carsten Brzeski discusses [in this note](#) what Germany’s January inflation data means for the European Central Bank. There is one part of his analysis that is particularly relevant for our FX views: slower inflation will not be a sufficient factor for the ECB to start cutting rates. Along with actual eurozone inflation hovering around 2.5% for a few months, long-term inflation forecasts will also need to remain unchanged at 2.0%, and nominal wages will need to come down to around 4%. Evidence from German data suggests some components of inflation (like services CPI, which accelerated in January) and a more unfavourable base effect from now on pose threats to ECB easing hopes.

Today, flash inflation estimates for the eurozone area are published, and the consensus is for a slowdown to 2.5% in the headline rate and to 2.9% in the core rate. A deviation from expectations could trigger short-term swings in eurozone rates and the euro, but should not really have a big impact on the narrative that Christine Lagarde and the Governing Council look set to reiterate next week. The ECB remains on the hunt for more conclusive evidence of disinflation, and EUR/USD looks likely to face another month of domination by the dollar leg rather than experiencing fresh eurozone-led dynamics.

*Francesco Pesole*

## ➔ CAD: Mixed data points to BoC’s holding pattern

Yesterday, fourth quarter growth figures beat expectations in Canada, coming in at an annualised 1.0% quarter-on-quarter. This follows evidence from retail sales that the Canadian economy entered the new year with better-than-expected momentum. At the same time, inflation is declining at a faster pace: CPI data showed both headline and core measures decelerating more than anticipated in January.

As discussed in [our latest Bank of Canada note](#), policymakers are now looking at a pretty mixed bag when it comes to data. Crucially, the unwinding of rate cut bets in Canada appears much more a consequence of rebounding Fed rate expectations than domestic factors. Ultimately, we

think the market is underpricing both Fed and BoC easing cycles, but March may be too early for a big dovish repricing.

We expect next week's BoC meeting to be of relatively limited relevance for markets. There is a risk that the message turns a bit more dovish (opening more explicitly to rate cuts) and hits CAD, but that should not change the picture dramatically for the loonie considering how much BoC expectations are tied to Fed pricing. We expect a stable USD/CAD in March before a USD-led decline in the pair materialises from the second quarter.

*Francesco Pesole*

## ➔ CEE: Confirmation of negative mood in manufacturing

In the Czech Republic, as [in Poland yesterday](#), GDP data for the fourth quarter of last year will be published, including a breakdown. The first estimate is likely to be confirmed, -0.2% year-on-year and 0.2% quarter-on-quarter. However, we see some chance for a slight improvement. Later, PMIs across the region will be released and we expect further confirmation of negative sentiment in the industry across the board. Also in the Czech Republic, the state budget for February will be released, which should show more on fiscal policy consolidation after a slightly negative number in January. On the speakers' side, today we should hear a speech from the Hungarian PM, who has been hitting the headlines often lately. FX remained almost unchanged yesterday despite higher volatility and our view remains the same, too. A stable Czech koruna and stronger Polish zloty and Hungarian forint.

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