

## FX Daily: Bank of Canada to hit the peak

The Bank of Canada is facing a hike/no-hike dilemma today. Our view is that it will deliver the last 25bp hike of the cycle now, but retain some flexibility to avoid sounding too dovish. The CAD impact may be slightly positive. Elsewhere, there are no key data releases in the US, while the German Ifo index will be watched closely after yesterday's strong PMIs



### ➔ USD: No key US data today

Yesterday's PMIs painted a less dramatic picture of the US service sector compared to the latest ISM survey and triggered a positive reaction in the dollar. However, markets quickly sold the USD rally, confirming a rather pronounced bearish bias despite encouraging data.

It does appear investors are happily buying the dip in EUR/USD around the 1.0850 handle at the moment, and that could prove to be a short-term floor for the pair. There are no data releases to highlight today and no Fed speakers due to the pre-FOMC blackout period.

Markets have cemented their view that next week's move will be a 25bp hike, but are still reluctant to fully price in another 25bp of tightening: the futures and swap market are embedding a 4.90% peak rate. This signals the perceived balance of risks is tilted to the dovish side ahead of next

week's FOMC. Should this narrative gain more traction this week, the dollar may remain gently offered. However, a sharper decline in the dollar may not be on the cards until other large event risks (European Central Bank, Bank of England meetings) are past us.

*Francesco Pesole*

## ➔ EUR: 1.0850 emerging as a short-term floor

A below-consensus reading in German manufacturing was the only flaw in an otherwise convincing set of PMIs in the eurozone yesterday. The eurozone composite PMI index moved back into expansionary territory (i.e. above 50.00) for the first time since June 2022, endorsing the ongoing re-rating of the growth outlook in the region.

As mentioned in the USD section, 1.0850 has emerged as a buy-the-dip area in EUR/USD over the past two sessions. Good data out of the eurozone is likely keeping most investors on the bullish side of the euro for now, and downside risks for EUR/USD appear contained. A test of 1.1000 by the end of the week is looking more likely, although a decisive break higher is not our base case before the ECB.

Today, the focus will be on the Ifo indices out of Germany. All three gauges (business climate, current assessment, and expectations) are expected to improve. Looking at the ECB pricing ahead of next week's meeting, it now seems very plausible that markets will not question a 50bp hike, although another half-point move in March is not fully priced in (around 80% implied probability). The degree of ECB President Christine Lagarde's commitment to another 50bp move will be the key driver of the market reaction next week.

*Francesco Pesole*

## ⬆️ CAD: BoC to hike one last time

Once a hawkish stand-out, the Bank of Canada is facing a hike/no-hike dilemma today. This is, at least, what market pricing seems to suggest, with 17bp of tightening priced in for today's announcement. Economists' consensus is leaning more in favour of a 25bp move, which is also ING's view.

As discussed in our [BoC preview](#), a still-tight jobs market is partly offsetting the decline in headline inflation and signs of economic slowdown, and probably suggests this is the right time to deliver the last 25bp hike of the cycle. Should the BoC surprise with a hold, there's a good chance the bank will keep the door open for a move in March, which would match the market's current pricing, and ultimately fail to hit the Canadian dollar.

A 25bp hike but a strong signal that rates have peaked and growing concerns on the economic outlook (new economic projections are released today) could prove to be a more dovish outcome than a "hawkish hold", as markets price in more rate cuts in the second half of the year. This is, however, hardly a desirable outcome for a central bank that is still fighting inflation, and our impression is that the BoC will want to retain some ambiguity around future moves for now.

The impact on CAD may be positive but rather limited in the end. USD/CAD remains on track for a move to 1.30 in the coming months, in our view, but USD weakness should be the primary driver of such a move.

Francesco Pesole

## HUF: Forint strongest since the middle of last year

The Hungarian central bank yesterday confirmed its commitment to keeping conditions tight for a longer period and that it has taken a patient approach to monetary policy. Moreover, the NBH reiterated its intention to continue withdrawing liquidity from the market via the one-week discount bill and the long-term deposit tender. More interestingly, the NBH raised the reserve requirement ratio for banks to 10% effective from April. Overall, it has sent a very clear signal that the hawkish mode will last for an extended period of time and the central bank is not going to allow any hasty moves. The result is a forint slightly below 390 EUR/HUF at the end of yesterday's trading, higher rates at the short end of the IRS curve and FX implied yields climbing higher.

The forint is thus the strongest since the middle of last year and we believe it could still benefit from yesterday's decision. Added to this is the higher EUR/USD level compared to last week and yesterday's renewed drop in gas prices back below €60/MWh. On the other hand, we may see some profit-taking today after the forint's multi-day rally and ahead of Friday's risky sovereign rating review from S&P. Overall, we expect the forint to stabilise around 390 EUR/HUF for now.

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