

FX Daily: Caught between a low rate and a strong US world

FX markets continue to trade in mixed fashion. The dollar is not quite sure whether it wants to rally on resilient US growth prospects or sell off in a world of lower market interest rates. Its path will not be decided today. Instead, we expect some more consolidation into next week's event risks of the US quarterly refunding and the FOMC meeting



USD: December PCE data should confirm benign price trends

[Yesterday's US data releases](#) certainly can be filed in the 'soft landing' drawer. Decent growth and benign inflation support the thesis that the Federal Reserve can make monetary policy less restrictive in an orderly manner and that, if the US economy does experience a recession, it will be a mild one. Equity markets seem happy to hold onto gains. The dollar does not know quite what to make of it. On the one hand, the mildly pro-risk sentiment should be a mild dollar negative. Yet, decent US growth plus rates falling faster in Europe than in the US are keeping the dollar mildly bid.

We doubt this challenge gets resolved in the short term, even though today's US Core PCE deflator should again come in at a very well behaved 0.2% month-on-month, 2.0% year-on-year and point to – as our US economist James Knightley puts it – the Fed's job being done. Given our view on a less-than-dovish FOMC meeting next week and potential market noise around Monday's

announcement of the US Quarterly Refunding, we suspect DXY can hold support levels near 103.00 and could nudge up towards the 104.00/25 area early next week.

Chris Turner

↓ EUR: President Lagarde stands by her rate cut

EUR/USD had taken very little notice of yesterday's European Central Bank policy statement, but lurched lower after President Christine Lagarde said she stood by the comments that she made last week that the ECB could cut this summer. The concept of data dependency was relegated to the back seat and instead two-year EUR swap rates fell about 12bp on the day and the market probability attached to an April rate cut rose close to 70% from 50% a day earlier.

The downside for EUR/USD looks open to the 1.0790/1.0800 area now and 1.0875/1.0900 looks like stronger resistance. And risks next week warn that EUR/USD could be a 1.0715/25 story. We are also surprised that EUR/CHF did not hand back more of its recent gains given that our recent call for EUR/CHF to trade to 0.95/96 is premised on higher euro market interest rates. If we are correct, however, in that the ECB does not cut until June and by only 75bp in total this year versus the 140bp currently priced – then EUR/CHF can still trade higher.

Elsewhere, EUR/GBP is closing in on major support at 0.8500 – but a break below it looks highly unlikely ahead of next Thursday's Bank of England meeting.

Chris Turner

➔ HUF: All eyes on the forint before the NBH meeting

The National Bank of Hungary will meet next Tuesday, giving the HUF more market attention than usual. EUR/HUF touched almost 388, however yesterday it bounced back to 382. Besides the central bank meeting wavering between a 75bp and 100bp rate cut, there is another story in the background. The Minister for Economy is proposing a change in the money market rate BUBOR which would be replaced by T-bills yields for corporate loans pricing. For now, this is just a proposal but it triggered an exchange between the minister and the central bank, which contributed to higher EUR/HUF volatility yesterday.

At the end of the day yesterday, HUF was stronger, but we also saw rallies elsewhere in the region, so the market takeaway is not entirely clear here. Looking ahead, lower EUR/HUF is good news for the central bank, and it may increase the pace of rate cuts to 100bp next week (which is now our baseline view). The interest rate differential has turned up in favour of HUF in the last two days, which should stop the recent sell-off. However, the situation reads poorly in the current environment and moreover, a stronger US dollar after yesterday is not good news for HUF and the CEE region.

Frantisek Taborsky

➔ CEE: Higher rates vs stronger US dollar

The calendar is empty in the CEE region today, so the focus will be more on global markets. In particular, US news and the resulting stronger US dollar will likely be the theme for today's CEE FX. Not just HUF but whole region saw a rally, supported by a fresh wave of payers in the rates market. From this perspective, the zloty seems to have the most potential to rally today towards 4.360

EUR/PLN. However, as we mentioned yesterday, we expect further upward movement later on due to the escalation of the local political situation. Also, the potential coming from rates will be held back by a stronger US dollar. EUR/CZK moved down a bit yesterday, back into our favourite range of 24.700-800, but for now we don't see a move in either direction here.

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