

FX Daily: Caught between inflation and a recovery

After - and perhaps because of - the positives of the strong February China PMI numbers yesterday, today sees the hangover of higher core rates around the world as investors re-price terminal policy rates. The US 2-year Treasury yield is closing in on a staggering 5%. Expect more of the same today with the focus on February core eurozone CPI



Source: Pexels

➔ USD: Trapped by opposing forces

Trade-weighted measures of the dollar are consolidating near recent highs and we suspect further volatility - rather than a clean trend - will be the story for coming weeks. Weighing on the dollar has been the pick-up in global activity as represented by yesterday's [February PMI release](#) from China. We will hear more on the China growth story this weekend as political leaders meet for their [Two Sessions](#). Also weighing on the dollar has been some aggressive re-pricing of central bank curves overseas - e.g. in the eurozone. For reference, since last Friday two year swap rates have risen 17bp for EUR, 10bp for USD and just 2bp for GBP.

Yet US rates have powered ahead too, with the US 10-year Treasury yield back above 4.00% and

the 2-year at 4.92%. Expect to hear more about the equity risk premium where investors will increasingly have to weigh up their incentives for holding equities if a two-year, risk-free investment in US Treasuries pays close to 5%. Higher rates around the world will clearly increase headwinds for risk assets - which is dollar bullish.

How will this story break? We have some important US data releases over the next week and key testimony from Federal Reserve Chair Jerome Powell next week which should shed a little light on how aggressive the Fed needs to be. Recall that Chair Powell did say on 1 February that the broad disinflation process has started. Key data releases will include tomorrow's ISM Services for February. Was the January rebound here weather related? And again the question of weather will be asked when the February US jobs numbers are released on 10 March. Unless we get clearer signs that the January data bounce was weather-related, the dollar will hold onto gains made in February.

For today, the dollar will probably take a back seat to events in Europe (core eurozone CPI) and we doubt US initial claims are a market mover. This could see DXY edge towards the lower end of a 104.00-105.00 range today.

Chris Turner

EUR: Look for a new cycle high in core eurozone CPI

As above, the re-pricing of central bank cycles has been more keenly felt in the eurozone than the US this week. That trend should be supported today with the release of February's core eurozone CPI which looks likely to exceed the 5.3% year-on-year consensus. We have had little push-back from the European Central Bank against the repricing of the cycle, which now seems to price the deposit rate above 4.00% early next year. That seems excessive, but let's see what today's release of the ECB minutes has to say.

Also important today will be comments from consistent hawk, Isabel Schnabel, speaking at the Money Market Contact Group in Frankfurt at 1330CET today. Will she push back against this aggressive pricing of the ECB cycle? EUR/USD may well be trapped in a 1.0600-1.0700 range today.

Chris Turner

CEE FX made a giant leap yesterday, as did the entire EM space, driven by positive news from China and the EUR/USD move higher. However, we do not think the US dollar has had the last word. So the CEE region may still benefit a bit today from yesterday's move but we do not expect a significant extension of recent gains. This should have been limited by the already very heavy positioning and in the case of the Czech koruna, near-historically strong levels.

Today's calendar in the region is almost empty, so the global story will be a decisive driver again. However, it is hard to see a significant trigger for a correction in the CEE region at the moment and thus we prefer to be rather bullish for potential further positive surprises for the EM space and persistent carry trades. From this perspective, it seems the Polish zloty could start to catch up with its CEE peers given its position as the only underperformer this year. In our view, everything negative on the table has been priced in and thus has room to get back on track supported by global momentum.

Frantisek Taborsky

⬇️ GBP: Decision Maker Panel survey is key today

As above, we note that short-dated GBP rates have not moved as much as EUR and USD rates this week. This trend was helped yesterday by very equivocal comments from Bank of England Governor, Andrew Bailey, who would not commit to further tightening. This has weighed on sterling and has unwound any gains from the [Windsor Framework agreement](#).

We have a down arrow on GBP today, because of the 1030CET release of the BoE's Decision Maker Panel survey. The BoE takes a lot of notice of this and what it says about tight labour markets. This has pointed to an easing in tight labour conditions including marginally weaker wage growth and less difficulty in recruitment. Assuming those trends continue, GBP interest rates can continue to fall behind those of the eurozone and the US and see some modest sterling downside. EUR/GBP could make a run at the 0.8930 area.

Also today we have BoE speakers in the form of Silvana Tenreyro (super dove, not market moving) and Chief Economist, Huw Pill (16CET). He should follow Andrew Bailey's line and again probably presents a slightly negative event risk to sterling.

Chris Turner

⬇️ BRL: When politics and central banking collide

The Brazilian real has been steady against the dollar, but weaker against our favourite currency in the world - the Mexican peso. We feel that political headwinds are growing for the real. Because of fiscal pressure, the new Lula administration is not rolling over fuel subsidies - these fuel subsidies had allowed Brazilian headline inflation to take a sharp turn lower last year. But having been elected on a mandate on supporting the less well-off, politicians are now pressuring Petrobras to cut its margin on fuel sales such that the removal of subsidies does not see fuel prices rise as much.

At the same time, politicians are keen for the central bank to start cutting interest rates - where the policy rate currently stands at 13.75%. However, in its most recent update, the central bank has warned about long-run inflation expectations increasingly moving away from target - clearly at odds with calls for rate cuts.

With core rates so high, we doubt investors will have too much patience for this kind of friction and we would favour further under-performance of the real. Were the politicians to increase their pressure on BACEN - the Brazilian central bank - then USD/BRL could trade up to 5.40.

Chris Turner

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