

FX Daily: CPI to press play/pause on the rally

FX markets today see one of the most highly awaited data points of the month - US CPI. The last two soft releases were the foundation for the fourth quarter rally in risk assets and today's release should determine whether this year's rally - and the decline in the dollar - continue. Next week's Bank of Japan meeting is also in focus as is strength in EUR/CHF



📌 USD: December CPI to determine whether risk rally continues

It has been a relatively good start to the year for risk assets. Global equity indices are up around 3.7%, led by Europe. Bond indices are up a decent 2-3% and emerging market assets are in demand, with EM local currency bond indices up close to 3%. This environment of money being put to work has weighed on the defensive dollar, which is softer against many emerging market currencies and quite a few G10 currencies.

This benign environment has been secured partially on the back of soft US price and activity data. Softer US price data has come both in the form of hard data and through surveys. Today sees the release of the December US CPI. Expectations are that the core will be rising at a relatively subdued

0.3% month-on-month pace and 5.7% year-on-year. This compares to 0.6/0.7% MoM readings last summer. As always, there are many moving parts in the data. For example, will medical costs and used car prices continue to drag the number lower? And does it remain too early to expect lower rental prices to drag shelter costs - a big component - down? Recently, the Federal Reserve has been highlighting that it is focused on the core services inflation reading ex-housing. So let us see what that number offers today. ING's US James Knightley is on consensus forecasting the 0.3% MoM/5.7% YoY reading.

A number in line with consensus probably allows the risk rally to continue. Expectations of a Fed easing cycle in the second half of the year, China reopening and lower energy prices are all encouraging this reallocation towards risk and should today's CPI number oblige, DXY could make a move towards the 102 area. Any upside surprise in the number could see DXY bounce to the 104.00/104.25 area, but we doubt it would completely spell the end for the better risk/softer dollar environment.

Chris Turner

📈 EUR: Showing some independent strength

The euro showed some independent strength yesterday and had quite a strong rally against European currencies - especially the Swiss franc (see below). Some tried to link that rally to a story that Germany would support fresh EU bond issuance to support state aid in Europe's fight against US green subsidies in its Inflation Reduction Act. That linkage seems a little far-fetched and European peripheral debt barely budged on the story. But we are still seeing eurozone equity outperformance, which must be providing the euro with some good support.

For today, the FX options market prices a 90 pip EUR/USD range for the CPI release. Assuming no upside surprises in CPI, the EUR/USD direction of travel looks towards the 1.09 area. 1.0660/1.0700 might well contain any downside today.

Chris Turner

📈 JPY: Bank of Japan meetings are all live

USD/JPY sold off in early Asia on a local media report that the Bank of Japan could again review its JGB yield target at next week's meeting. The report suggested December's widening of the JGB yield target band might not have been enough to address the BoJ's concerns over bond market functioning. The report also suggested that the BoJ would raise its fiscal 2023 and 2024 inflation ex-food forecast to 2% - effectively signalling the end of its deflation fears. This comes at a time of much focus on a pick-up in wages in Japan and a more sustainable rise in inflation.

The FX options market prices a 1.3% range for USD/JPY today, where a benign US data print could send USD/JPY back to this year's low at 129.50. Next week's BoJ meeting means that any upside should be limited to the 132.60/133.00 area.

Chris Turner

➡ CHF: Wrong

We had been forecasting a lower EUR/CHF this year on the view that the Swiss National Bank wanted a stronger nominal Swiss franc to fight inflation. Instead, EUR/CHF yesterday broke above

1.00. There are probably two factors driving the move. The first is that USD/CHF is a lot lower, meaning that the SNB is getting its stronger Swiss franc via gains against the dollar and does not need it a lot stronger against the euro. The second is that the hawkish European Central Bank and the further 125bp of tightening expected will out-tighten the SNB.

Given that it looks like the dollar will stay offered for the time being and the ECB looks unlikely to relent on its hawkishness, this trend to a higher EUR/CHF may remain in place. However, we doubt the SNB would want to see a big rally this early and the move may stall in the 1.0070/1.0100 area. We had thought EUR/CHF could trade to 0.95 this summer, but it looks like we will have to revise up those forecasts.

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