

## FX Daily: Dazed and confused

The Bank of Japan defied hawkish speculation and held policy steady this morning, sending the yen lower. Some market confusion was also generated by a headline suggesting the European Central Bank is mulling slower rate hikes: clarifications may come from Davos by the end of the week, and the euro may recover. In the US, the data calendar picks up again



The Bank of Japan in Tokyo

### ↓ USD: US data back in focus

An exceptionally grim Empire Manufacturing reading for January has been the only noteworthy data release out of the US so far this week, and the dollar has continued to be a bystander as developments in Japan, Europe and China drive most market moves. Today, retail sales, PPI, industrial production and TIC flows data will be in focus. The market's scrutiny over the US economic outlook has grown exponentially since the ISM service report pointed to an imminent recession: expect more pain for the dollar should fresh signs of a slowdown emerge now that the US data calendar is picking up again. The Fed's Raphael Bostic, Patrick Harker and Lorie Logan are set to speak today.

The fall in the yen after the BoJ announcement (more details in the JPY section below) is offering some relief to the dollar this morning. However, we suspect this may only prove temporary and

downside risks into the 101-102 area still prevail in the very near term.

After all, the global environment continues to be rather benign for the ongoing rerouting of flows into emerging markets and high-beta currencies. The growing feeling that China may face a reality check on the sustainability of looser Covid rules may be contributing to halting CNY gains, but recent data gave reasons for optimism on Chinese growth, [as noted by our colleague Iris Pang here](#). We are also approaching the lengthy Chinese New Year holiday season, which may be keeping some investors on hold before moving significantly into Chinese assets.

Our commodities strategists have revised their forecasts for [iron ore](#) and [copper](#) prices higher on the back of China's reopening. A demand-driven improvement in the metal price outlook is an ideal scenario for commodity currencies: the Australian dollar is a good example here, also considering the tentative conciliatory steps in Sino-Australian diplomatic relations. Indeed, the Reserve Bank of Australia's policy remains an open question: the [resilience of inflation](#) poses risks to our conservative call for only two more 25bp hikes before the end of the hiking cycle, and could add some more steam to the AUD rally. A 0.70-0.72 range could easily become the norm for AUD/USD in the next few weeks.

*Francesco Pesole*

## EUR: Conflicting news

Yesterday was a day of conflicting headlines for the euro. In a long [interview](#) to the Financial Times, Chief Economist Philip Lane offered elaborate reasoning to support the ECB's recent hawkish rhetoric. However, later in the day, a Bloomberg report cited some ECB officials saying that Governing Council members are actually considering a slower pace (25bp) of tightening. EUR/USD dropped below 1.08 on the news.

It does seem premature for the ECB to unwind its hawkish narrative just yet, and we would not be surprised to see some remarks aimed at "mitigating" yesterday's dovish headline. Francois Villeroy (today) and President Christine Lagarde (tomorrow) have a chance to do so in Davos. Either way, the overall environment looks likely to stay largely supportive for EUR/USD and a return to 1.0850-1.0900 seems possible by the end of this week.

Other conflicting headlines came from Germany. Chancellor Olaf Scholz said he's sure that Germany will avoid a recession, while his finance minister suggested in a previous interview that there will indeed be a recession, but it should be very mild. The ZEW expectation survey (which spiked into positive territory yesterday) surely seemed to favour more optimism on the German outlook, and undoubtedly fed into the divergence in growth narratives between the eurozone (increasingly upbeat) and the US (increasingly downbeat). This ultimately makes us believe EUR/USD can stay mostly supported for now.

*Francesco Pesole*

## GBP: Inflation matches expectations

December CPI numbers were [released in the UK this morning](#) and largely matched consensus expectations. Headline inflation decelerated from 10.7% to 10.5%, while the core rate held at 6.3%. With the peak apparently past us, we could see headline inflation return to 6% in the summer and 3.5-4% by year-end, according to our economists.

It's important to note that core *services* jumped from 6.4% to 6.8%, a development that the BoE should particularly take into consideration, and when added to yesterday's wage data should tilt the balance towards a 50bp hike in February.

EUR/GBP is back to pre-Christmas – sub-0.8800 levels – thanks to some idiosyncratic EUR underperformance and a supported pound. As discussed in the euro section above, ECB-related weakness in the euro may not last long, and EUR/GBP may struggle to trade sustainably below 0.8800 for now – also given the lack of strong bullish forces in the pound.

*Francesco Pesole*

## 📌 JPY: No hawkish surprise by the BoJ

The Bank of Japan's decision to leave its policy tools unchanged has seen USD/JPY live up to its pricing as one of the most volatile pairs in the G10 space. We expect that to continue. The big correction higher in USD/JPY may endure for a little while. This is because the BoJ's forecasts for CPI ex-food remain below 2% for FY23 and FY24 and could make the case for the new BoJ governor in April to continue with the current ultra-loose policy.

Yet USD/JPY is down at 130 on both the BoJ and the dollar story. We look for a broadly weaker dollar – especially in the second quarter when US core inflation should fall more quickly. This means USD/JPY should again come under pressure from the dollar side. And plenty of speculation over a BoJ policy shift in April should limit USD/JPY upside too. We see this correction stalling in the 132.50/133.00 area (outside risk to 135), with a bias to 126/128 for the end of the first quarter. Later in the year USD/JPY will probably be trading under 125.

*Chris Turner*

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