

## FX Daily: Dollar remains vulnerable

FX markets are consolidating ahead of tomorrow's important December US CPI release. But the dollar bias is lower. Business surveys point to a slowing US economy and, if inflation allows, the Fed will be in a position to ease policy later this year. Commodity markets remain bid on the China rebound story and we expect emerging and commodity FX to remain bid



### ⬇️ USD: Business pessimism builds

We highlighted in yesterday's publication that the day presented two event risks to the building dollar negative sentiment. Those were Federal Reserve Chair Jerome Powell's comments at a Riksbank symposium and the US NFIB small business confidence reading. In the end, Chair Powell avoided discussing monetary policy and instead warned against central bank mission creep into climate policy. And the NFIB survey was very pessimistic indeed, including a view on pricing power which ING's US economist, James Knightley, says is consistent with US core inflation dropping to a more comfortable 2-3% year-on-year area by the late summer.

That core reading is currently running at 6.0% year-on-year and is expected to drop to 5.7% YoY in tomorrow's December CPI release - the key US release this week. Thus this year's FX market proposition remains whether US inflation can acquiesce enough to allow the Fed to cut

later this year. The markets price a 50/60bp hike into the spring, then a cut of a similar magnitude by year-end. A further 150bp of easing is priced into next year. ING's house view is a little more aggressive, looking for 100bp of cuts this year and then a further 150bp next year.

Assuming no upside surprises in inflation then and the increasing focus on China firmly supporting domestic demand, the risk environment is being read as positive. We note copper, a key barometer of Chinese demand, climbing back to \$9000/MT in Asia today. We think investors will therefore be looking to sell the defensive dollar on rallies as they put money to work in 2023. As always, we think the short end of the US yield curve will play a major role in FX markets and as long as two-year US Treasury yields continue to hover near the range lows at 4.20/4.25%, the dollar will stay on the soft side.

DXY remains soft and we would say the near-term bias remains towards the 102.00 area, unless tomorrow's US CPI release throws a hawkish curveball. The US event calendar looks exceptionally light today, although we will start to see US quarterly earnings releases build through the week.

*Chris Turner*

## 📈 EUR: Options market turns more bullish

EUR/USD remains gently bid, buoyed by expectations of a Fed U-turn in the second half of this year, China reopening and a belatedly hawkish European Central Bank. On that subject, we have four ECB speakers today. Market expectations are firmly set on a further 125-150bp of ECB tightening this year - seemingly 50bp hikes in both February and March and a final 25bp in May to take the deposit rate to 3.25%. Our eurozone team agrees with this pricing.

Looking at the FX options market we can see EUR/USD optimism continuing to build. Measures such as the risk reversal - the cost of a 25 delta EUR/USD call option versus a similar EUR/USD put option - continue to move in favour of EUR/USD upside. As recently as October, the markets were prepared to pay 2% extra in volatility terms for a 3-month 25 delta EUR/USD put option. That skew for euro puts has now narrowed to 0.67%. The skew turning positive - in favour of EUR/USD calls - would be a big moment for the FX market.

As above, the seemingly benign investment environment (despite the horrors in Ukraine) probably has investors wanting to buy EUR/USD on dips. It is the time of year when FX markets move on fixing flows from the asset management community. Today's EUR/USD bias looks towards resistance at 1.0785 and potentially towards the 1.09 area tomorrow, should the US CPI release oblige.

*Chris Turner*

## ➡ JPY: Lots of focus on the BoJ

USD/JPY is consolidating at the lows and the focus very much remains on Bank of Japan (BoJ) policy after December's surprise widening in the 10-year JGB yield target band. 10-year JGB yields continue to press the topside of the new +/- 0.50% band, with the expectation growing that the band will be widened to +/- 1.00% over the coming months. Despite the BoJ marketing these adjustments as a measure to address JGB market functioning, investors are reading this as BoJ tightening - and yen positive.

Focus on the exit of the ultra-dovish BoJ governor in April means that investors will be very

cautious selling the yen over coming periods. One month realised USD/JPY volatility is still at an incredibly high 16.5% - making the JPY far too volatile for any kind of funding currency - and we think USD/JPY can end the quarter somewhere near 128.

*Chris Turner*

## ➔ CEE: Czech inflation to rise again

Yesterday's [meeting](#) of the National Bank of Romania (NBR) brought a 25bp rate hike to 7.00%, as expected. Although we consider this to be the last hike in this tightening cycle, we feel that the NBR wants to keep the door open if needed. But probably the most interesting part is the dropping of the "firm liquidity control" commitment. While dovish in essence, we read this more like an after-the-fact acknowledgement rather than any forward guidance. The Romanian leu barely changed yesterday but we still think it should benefit from global factors, catch up with the lag behind the region and make another move below NBR levels.

Today, the focus shifts to the Czech Republic. December [inflation](#) we think will show a rise from 16.2% to 16.4% year-on-year, above market expectations. However, as we showed earlier, there is still room for upside surprises. Moreover, fuel prices are the main reason for slower inflation than we have been used to, while inflation remains strong in other parts of the CPI. For the market, the higher number should be a reminder that the inflation problem is still with us and this may be the first opportunity this year to reassess the strong dovish expectations built up recently. At the one-year horizon, markets expect a 170bp rate cut, which is hard to believe given the current Czech National Bank rhetoric, the record strong koruna and the inflation profile.

However, the koruna is looking the other way and ignoring domestic conditions. More important for it and the entire CEE region at the moment is the global story, the massive improvement in sentiment in European markets and gas prices below EUR70Mwh. This, in our view, should keep the positive sentiment in the region at least for the rest of the week and keep FX steady.

*Frantisek Taborsky*

### Author

#### **Chris Turner**

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### **Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

#### **Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

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