FX Daily: Dollar set to hold gains through February

Yesterday's strong US January CPI release clearly does not provide the Fed with the confidence it needs to start cutting rates. Instead of powering the next leg of the risk rally, the CPI data has applied the brakes and suggests the dollar largely holds onto its gains into the next big US price release – the January PCE data on 29 February

USD: Setting up another good month for the dollar

US January CPI figures have made uncomfortable reading for the Federal Reserve. A core inflation reading of 0.4% month-on-month and nearly 4% year-on-year is not a good look for a central bank preparing to cut rates. It is no surprise that the December 2024 Fed Funds futures contract sold off 24 ticks yesterday and the market has scaled back expectations for 2024 Fed easing to 90bp from a view of 160bp just three weeks ago. As our US economist James Knightley discusses here, the seeming divergence between the CPI numbers and the Fed's preferred measure of inflation – the core PCE readings – will only confuse the Fed. And clearly, these numbers are not giving the central bank the kind of confidence it needs to declare that the inflation battle is over. Add in the fact that January's US jobs data was strong across the board as well, which also brings into question the Fed's position that the US labour market is coming back into better balance.

The strong inflation print generated a predictable market reaction – a bearish flattening of the US yield curve, weaker equities (especially growth stocks), and a stronger dollar. Looking across the FX space on a total return basis, the dollar is the strongest performer in the G10 space this year and is only bettered (marginally) in the EM space by the Turkish Lira, Indian rupee, and Mexican peso. Given seasonal patterns favour the dollar in February and that the next big input into the Fed equation, the January PCE data, is not released until 29 February, it looks like the dollar will be able to hold recent gains for another couple of weeks. DXY can trade on the firm side of a 104.60-105.00 range today.

Elsewhere, the broad-based dollar rally has taken USD/JPY well above 150. Because this is a dollar rather than a yen-led move, the consensus view is probably that Japanese authorities will not be able to justify any FX intervention. We are not so sure and suspect the US Treasury would again accept Japanese intervention to sell USD/JPY should it make a quick move to 152. At just 7.45%, one week USD/JPY implied volatility seems too low in that intervention cannot completely be ruled out.

Chris Turner

EUR: Wider rate differentials and softer equities weigh

Yesterday's US CPI data briefly pushed EUR/USD two year swap rate differentials back to the widest levels of 2023. Add in a sell-off in equities and it was understandable that EUR/USD came under pressure. This means that EUR/USD continues to unwind the late 2023 rally and a break under 1.0700/0710 opens up 1.0660 and possibly even 1.0610. However, with Fed easing expectations moving back to more conservative pricing (and nearer to the Fed's own expectations of 75bp of easing this year) we suspect the 1.06/1.07 levels may be a good area for corporates to hedge long dollar or short euro exposure.

In terms of the calendar today, eurozone fourth quarter GDP for 2023 should be confirmed at 0.0% quarter-on-quarter and we have several European Central Bank speakers – split between the hawks and the doves. The re-pricing of the Fed cycle has also dragged euro short-term interest rates higher. This means that EUR:CHF two-year swap rate differentials have widened in favour of the euro and EUR/CHF has traded back above 0.95 again. We think this trend has a little more to go and had forecast 0.96 for the next few months.

Elsewhere, the UK has just released some welcome January CPI numbers, where headline and core figures have come in marginally lower than expected. The CPI services figure, which is closely watched by the Bank of England, has edged up to 6.5% YoY but remains lower than the 6.8% consensus. This softer data has helped EUR/GBP bounce off support at 0.8500 and sent GBP/USD under 1.2600 again. Look for testimony from the Bank of England's Andrew Bailey at 4:00pm CET, where he may shed more light on whether the BoE is confident enough to be cutting rates later this year. This probably should be seen as a negative event risk for sterling.

Chris Turner

CEE: Fourth quarter shows improvement but still last year was disappointing

Fourth quarter GDP numbers across the CEE region are being released this morning. In Romania, economic growth accelerated from 1.1% to 2.9% YoY. In Hungary, the numbers are also out and improved from -0.4% to 0.0% YoY, below market expectations. In Poland, figures will be released later, but we expect some acceleration here too from 0.5% to 1.0% YoY. This will complete the picture for the CEE region for the fourth quarter and the whole of last year – which was rather disappointing. The Czech Republic numbers were reported earlier with an improvement from -0.8% to -0.2% YoY, clearly the weakest economy in the region. For this year, we expect a strong recovery across the region of around 3%, with the exception of the Czech Republic where we expect just over 1%. Also released this morning was January inflation in Romania, which showed a rise in inflation from 6.6% to 7.4% YoY, highlighting the difference between the rest of the CEE region with lower headline inflation. This was also seen by the central bank, which left rates unchanged yesterday – catch up our latest NBR review in more detail.

Yesterday's US CPI data was clearly negative news for FX in the CEE region, and we have seen significant weakness across the board as a result. PLN is showing the biggest losses, postponing our hopes of reaching the 4.30 EUR/PLN that we mentioned yesterday. The currency pair followed a spike in core rates, and PLN rates have had trouble catching up given the already elevated levels. The main driver today will be the reverberations in the core rates market. However, we believe that EUR/PLN will not go much higher from current levels and instead, the market will take advantage of weaker PLN levels to enter here.

Frantisek Taborsky

CZK: Unfortunate timing for currency

As with the Polish zloty, yesterday's surprise in US inflation data means another threat to the Czech koruna (CZK) as well. This comes after a sharp depreciation of more than 1% following the central bank's decision last week. EUR/CZK thus touched 25.40 yesterday, pushing record highs again. For now, the central bank seems more interested in medium-term than daily volatility, so we do not draw big conclusions here. However, we think tomorrow's inflation numbers will provide more reasons to price in more rate cuts, which could hit the CZK again.

On the other hand, from a rates market perspective, we are approaching the point where all room for rate cuts will be fulfilled and the CZK will be driven more by core rates and differentials against the ECB. In the short term, we could see further weakness touching 25.50 EUR/CZK (despite our previously more optimistic CZK view) and EUR/CZK moving down later. The Czech National Bank still has plenty of time before the March meeting in six weeks, but even so, we will have to watch the CZK closely.

Frantisek Taborsky

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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