

## FX Daily: Energy markets dominate

The December FOMC minutes caused barely a ripple in the FX market. Instead, investors are left to interpret China's battle with Covid and plunging energy prices. The sharp fall in natural gas prices is a boon to European energy importers, but a Fed still concerned with tight labour markets suggests the European FX recovery against the dollar is limited



### ➔ USD: FOMC minutes barely move the needle

Last night's release of FOMC minutes could have been perceived as slightly hawkish, yet FX and interest rate markets barely budged. At the heart of the 2023 story is the risk management trade-off of the Federal Reserve under-appreciating sticky inflation versus over-tightening and delivering weaker-than-needed growth. For the time being, the Fed is still more concerned by the former and plans ongoing rate increases. In practice, we think that means another 50bp hike from the Fed in February (the market seems to prefer 25bp hikes in February and March) and then rate cuts from the third quarter onwards. For rate markets the battle this year seems to be whether inflation will allow the Fed to deliver the roughly 50bp of easing expected in the second half of the year.

For today's session, the focus will be on the December ADP jobs data, where a +150k number is expected after last month's 127k rise. Currently, the consensus expects tomorrow's December nonfarm jobs reading at +200k. Yesterday we highlighted the importance of the JOLTS job opening data. The December figure showed a surprise rise, which will fan Fed fears of the US labour market staying tight. A firm ADP number today could also deliver a little support to US yields and the

dollar.

Away from the Fed story, the market's early year focus is on China's Covid battle and slumping energy prices. Commodity markets - always very sensitive to the China demand story - are taking a cautious approach here. In other words, they are not prepared to look through (presumably) surging infections towards the second half growth story. Equally the China story, in addition to very warm weather, is weighing on energy prices where both oil and gas are plunging. Indeed, European natural gas now trades at a discount to Asian natural gas and warns that LNG shipments [will be re-routed to Asia](#). For the time being this fall in natural gas is prompting a re-assessment of European growth prospects and supporting European FX - especially CE4 currencies. That may well remain the near-term trend unless US price data is sufficient to re-price the Fed tightening cycle to the 5.50% area and lift the dollar.

As above, ADP will be key for the dollar today. A subdued DXY range well within 104-105 looks likely.

*Chris Turner*

## ➔ EUR: A welcome reprieve from energy

The sharp fall in energy prices is being welcomed across Europe. That is already showing up in softer-than-expected German and French inflation data. Today the focus will be on Italian inflation data ahead of tomorrow's eurozone December CPI release, currently expected at 9.5% year-on-year. As discussed yesterday, the sharp fall in natural gas is generating even further improvement in the euro's terms of trade and is a euro positive. However, EUR/USD may struggle to make further upside gains until key event risks have been surmounted such as tomorrow's December US jobs release and next Thursday's US December CPI reading. Expect EUR/USD to continue trading in a 1.0580-1.0640 range, though we would probably say the upside risks are greater given developments in the energy story and the re-rating underway of European equities.

Elsewhere, the National Bank of Poland left rates unchanged at 6.75% yesterday. [Our team feels](#) that sticky inflation will not allow an easing cycle to materialise in the second half of this year, however. Look out for the press conference from NBP Governor Adam Glapinski at 15CET today. 7.5% implied yields for the zloty and a rally in European bond markets amid lower energy prices can probably keep EUR/PLN gently offered for the time being.

*Chris Turner*

## ➔ GBP: PM Sunak's new targets

The UK Conservative government came out on the offensive yesterday with Prime Minister Rishi Sunak announcing five strategic targets for this year, among which were halving inflation, stabilising debt to GDP and ensuring a return to growth. The reduction in inflation may be the most attainable of these three and the one over which the government has the least control.

On the subject of inflation, today sees the 1030CET release of the Bank of England's Decision Maker Panel (DMP) survey. This looks at inflation expectations in the business sector. The November survey, published in early December, saw one-year inflation expectations drop to 7.2% from 7.6% YoY. Presumably, this should fall again in today's survey. We still think the market is over-pricing the BoE tightening cycle at a peak near 4.50% (+100bp) in August this year. But that pricing has

been resolute.

EUR/GBP should continue in a 0.8800-0.8850 range for the time being, while cable can loiter well within this week's 1.19-1.21 range.

*Chris Turner*

## 📉 EGP: Another devaluation in the Egyptian pound

The Egyptian pound (EGP) sold off another 6-7% yesterday. This is a heavily managed exchange rate and the decline is taken as a controlled move by local authorities. The fall in the pound also saw Egyptian hard currency foreign debt rally on the view that authorities were conforming to IMF conditionality of a flexible exchange rate in return for the \$3bn IMF facility agreed in October.

The legacy of the 2022 inflation and interest rate shock to emerging markets continues to play out in Africa, where sovereign CDS premia remain among the highest in the world. Among those sovereign credits under pressure is Nigeria, which also has a heavily managed exchange rate. The Nigerian naira was allowed to depreciate 4% in December, but with implied yields still at 50% - expecting further naira depreciation - we can only think that lower energy prices will be heaping more pressure on this currency. Those forwards price USD/NGN at 500 in three months' time - which certainly looks to be the direction of travel.

*Chris Turner*

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