

FX Daily: EUR/USD zeroing in on 1.10

We think EUR/USD may break 1.10 next week before the US payrolls, as the dollar remains vulnerable despite some repricing of dovish Fed expectations, and confirmation that core inflation remains sticky in the eurozone today should endorse ECB hawkishness. If that's the case, Cable should follow with a break above 1.25



➔ USD: Struggling to find support

The dollar has continued to lose ground across the board. The pause in the greenback decline only lasted for one day (Wednesday) but resumed yesterday. Interestingly, we are once again observing dollar weakness in tandem with a repricing higher in Fed rate expectations – a May hike is now 60% priced in – and evidence of improving liquidity conditions among US banks. US institutions had \$152.6bn in outstanding borrowing in the past week, a decrease from \$163.9bn in the week before.

In our view, all this continues to point to how markets are “punishing” the dollar for the unclear Fed communication and instead favour the currencies – like the euro – where there is a clearer (and hawkish) policy direction. We have been highlighting recently how the calm in markets and the marginal improvement in liquidity conditions among US banks does offer room for Fed officials to sound more hawkish, and indeed we heard from Susan Collins yesterday calling for more tightening. But we suspect markets need some clarifications in this sense from Fed Chair Jerome

Powell himself, and we do not see any scheduled speech from him in the foreseeable future.

Meanwhile, we'll hear from two voting FOMC members today: John Williams and Lisa Cook. They are not known hawks so any tilts towards more hikes in their rhetoric could have some impact. On the data side, the focus will be on February's PCE deflator, the Fed's preferred measure of inflation. Our economists are aligned with consensus in expecting the core measure to come in at 0.4% month-on-month, which should translate into a stabilisation of around 4.7% YoY. The headline rate should decelerate but may stay above 5.0%. Personal spending data for February will also be released.

Barring a major upside surprise, we don't expect a material impact on the dollar from PCE data today. As we have seen, higher chances of a May hike don't automatically translate into a stronger dollar in the current market environment. We could see some dollar stabilisation after a week of losses, but the short-term bias remains negative for the greenback.

Francesco Pesole

➔ EUR: A pause before another jump?

We have been calling for 1.10 in EUR/USD for some time now, and with yesterday's leg higher in the pair having seen a break above 1.0900, we should probably suggest a time for when that level will be reached.

We think today the risks are more skewed toward consolidation in the pair, and have indeed seen some pullback from the 1.0930 levels back to 1.0900 during the Asian session on the back of a slight dollar recovery. Inflation data in the eurozone will be an important driver, but a big chunk of the move already happened after yesterday's [German figures](#) were released.

This morning, Dutch inflation dropped more than expected, to 4.5% (Harmonised CPI YoY) from 8.9% in February. French data are also due early this morning, followed by Italian and finally eurozone-wide numbers. The consensus for the flash estimate is set for 7.1%, a much-anticipated energy-driven drop from 8.5%. However, core inflation is seen ticking higher from 5.6% to 5.7%, which is probably what the market should tilt the balance for markets.

Ultimately, even if a CPI-led rally may have already happened yesterday, EUR/USD may find some floor around 1.0870/1.0880 in the face of a potential dollar recovery with eurozone-wide data confirming core inflation requires more ECB tightening. Anyway, our bias remains bullish for EUR/USD, and we think that 1.1000 can be broken sometime next week, barring surprisingly strong ISM data out of the US and amid an otherwise broadly quiet data calendar until Friday's non-farm payrolls.

We have some ECB speakers to keep an eye on today: President Christine Lagarde, Latvia's Martins Kazaks, Italy's Ignazio Visco and Croatia's Boris Vujcic.

Francesco Pesole

➔ GBP: No reasons to diverge from EUR

The pound is set to be the best-performing currency of the first quarter of 2023, having gained 2.5% against the dollar. Along with the improvement in the economic outlook, sterling is definitely drawing benefits from the market's conviction that the Bank of England will need to continue

raising rates. Indeed, Monday's comments by Bank of England Governor Andrew Bailey did lean on the hawkish side and largely endorsed market pricing, but our economics team remains doubtful that the data will ultimately underpin the need for additional tightening. This morning's revision of fourth-quarter GDP data on the strong side is probably too outdated to have a material impact in this sense.

Still, we have been stressing how markets are rewarding currencies that can count on domestic tightening prospects despite financial turmoil, and the pound is indeed one of those. While our more dovish view for the BoE compared to the ECB keeps us bullish on EUR/GBP for the remainder of the year (we still target 0.90 in the second half of the year), there aren't clear short-term drivers to buck the bullish GBP trend at the moment.

Cable is approaching some important levels. First of all, the 1.2426 December 2022 high, and then the key 1.2500 benchmark level. With no obvious catalyst driving divergence between EUR and GBP at the moment, a high chance of 1.1000 being tested next week in EUR/USD equals a high chance of 1.2500 being tested next week in Cable.

Francesco Pesole

CEE: Zloty may join the club again

Today, the market's attention in the region will shift to Poland where we will see the March inflation numbers, the first inflation numbers in the CEE region. We expect CPI to slow from 18.4% to 16.0% YoY, in line with market expectations. Although this should be the first drop since February's peak, prices are being pushed up by the core component as well as food prices.

Elsewhere in the region, we will see the final estimate of GDP in the Czech Republic, which will show the full detail of the economy's decline at the end of last year by 0.4% quarter-on-quarter. On the political front, the non-binding deadline for the Hungarian government to approve the necessary legislation to gain access to read EU money ends today. However, it is not very clear when we could hear more, especially from the European Commission.

The positive conditions for FX that we highlighted earlier prevail in CEE markets and we expect the good mood to continue into the end of the week. Our favourites continue to be the Hungarian forint and the Czech koruna, which should post further gains. However, the Polish zloty is coming to life, as we highlighted last week that its time is coming. Yesterday, the zloty closed below the 4.680-4.720 EUR/PLN range for the first time in the last two weeks. Our models imply that over the past three weeks, the zloty has re-established its relationship with global after a long period, and its beta is approaching that of the forint and the koruna.

It seems that the market wants to put aside the domestic problems and perceives the zloty as part of a region that currently has ideal conditions for recovery, as we mentioned before. Overall, the zloty could finally see some gains and get rid of the label of the only underperformer in the region this year. Today, of course, the March inflation number will be decisive, but for the following weeks, global conditions could be the main driver. For now, we see 4.670 as the next level for the test.

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