

FX Daily: Eyes back on data after Fed and ECB communication troubles

Markets questioned the hawkish message by both the Fed and the ECB this week, but we think Powell gave more reasons to reasonably fuel dovish expectations. Still, the ECB communication hiccups mean that EUR/USD may struggle to break higher before the end of the first quarter. Today, eyes on payrolls and ISM services: the dollar likely faces downside risks



We think the case for a growing divergence between an immobile FOMC and a bunch of dovish central banks is getting stronger

⬇️ USD: Downside risks from data today

The dollar has essentially erased all the post-FOMC losses after markets questioned the hawkish rhetoric by the ECB and European rates went on a huge rally yesterday. We analyse what the last two days of central bank meetings have meant for EUR/USD [in this note](#).

It's been quite clear that markets have doubted both Fed Chair Jerome Powell's and ECB President Christine Lagarde's attempts to hang on to hawkish communication, although dovish bets on the Fed appear more strongly founded at this stage. This is both because Powell seemed more relaxed about the easing in financial conditions and did not convey urgency in pushing back against rate cuts, and because the Fed has taken rates into a much more restrictive territory which inevitably

leaves a larger room for easing in 2023.

What is clear is that markets will continue to focus heavily on data. With volatility abating after the key Fed and ECB announcements and some of those defensive trades (due to the imminence of key risk events) being unwound, today's non-farm payrolls release in the US brings mostly downside risks for the dollar, in our view.

After all, a tight jobs market has already been factored in by the Fed (Powell even admitted inflation might fall without hurting employment), but it's really the declining inflation story that is suggesting a peak in Fed funds rates is imminent. Accordingly, markets may focus more on the wage growth figures rather than the headline employment print. Any evidence that wage growth is losing pace and/or that hiring is slowing down materially would likely fuel rate cut expectations further, and hit the dollar. US 2-year rates are currently trading 10bp above the psychological 4.00% mark: a break below may exacerbate a dollar slump. Should such dollar weakness materialise, we think that high-beta currencies may emerge as key winners thanks to the positive impact on risk assets.

ISM service numbers will also be closely watched after the latest release was a key driver of the negative re-rating in US growth.

Francesco Pesole

⬆️ ECB: Dealing with unclear communication

Should today's payrolls trigger a dollar contraction, the euro may emerge as a laggard in the G10 space. Markets are strongly questioning the ability of the ECB to keep hiking at a "stable" pace (as the ECB said in its statement) beyond the March meeting. Here are the review notes from our economics team of yesterday's [statement](#) and [press conference](#).

As our ECB watcher puts it, Lagarde's press conference brought more fog than clarity. And we think it is indeed the communication hiccups in Frankfurt that is [driving EUR/USD weakness](#). We remain of the view that at least 75bp of extra tightening will be delivered by the ECB, which still puts EUR/USD in a position for a big rally in the second quarter – when US short-term rates may come off more steadily. The ECB communication troubles may cap EUR/USD before then.

Today, the balance of risks is still tilted to the upside for EUR/USD as US jobs data will be the key driver. The question is how comfortable markets are with re-testing 1.1000: we suspect a break above that level is a bit premature unless US figures come in very weak.

Francesco Pesole

⬆️ GBP: BoE close to the peak

The Bank of England hiked rates by 50bp yesterday, but offered a number of signals that it is indeed close to the peak. As discussed in our economics team's [reaction piece](#), a key hint that the MPC is laying the groundwork for the end of its tightening cycle is that it has dropped its pledge to raise rates "forcefully" (i.e. by 50bp). Incidentally, the BoE's two-year inflation projection – a key driver of policy decisions – is now well below target.

We still doubt this was the last hike of the cycle, and expect another 25bp move at the next meeting in March. Markets are torn around a move in either March or May, but are still fully pricing

in an additional 25bp of tightening.

The pound was slightly weaker after an initially positive reaction to the BoE statement. In practice, it appears that the BoE is not diverging much from market expectations, which means that it may be up to data in the UK to drive any large swings in the pound rather than surprises from the BoE. With markets doubting the ECB's hawkishness, EUR/GBP may manage to stay below 0.9000 for now, although a break higher seems highly likely over the coming months.

Francesco Pesole

CZK: CNB continues to support FX but is not a decisive factor

The Czech National Bank (CNB) left rates and the FX intervention regime unchanged yesterday, in line with expectations. However, there was still room for a [hawkish surprise](#). During the press conference, the Governor said that the record-strong koruna is not a problem for the economy and on the contrary, it is a welcome inflation-fighter. He thus implicitly confirmed that the intervention regime will be with us for a long time despite the fact that the CNB last intervened in September last year. Moreover, he told reporters that current expectations of significant rate cuts this year are wrong and rates will remain at higher levels for longer.

However, the main driver at the moment, in our view, are global factors – falling gas prices and a higher EUR/USD – and the CNB is more of a complementary factor for the positive koruna. Moreover, the koruna still offers decent and stable carry. Thus, the main enemy at the moment is the market positioning, which was already the longest in the CEE before the CNB meeting in our view. Thus, the koruna may test 23.70 levels in the short term but the EUR/CZK move lower is limited in our view and the koruna will be rather stable compared to CEE peers.

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