FX Daily: Fed hawks consider ‘pent-up exuberance’

The mood music coming through from the Fed remains one of there being no rush to cut rates. Yesterday, Atlanta Fed President Raphael Bostic talked of there being 'pent-up exuberance' in the business sector, which could be a problem for inflation if the Fed cuts too quickly. Expect USD to hold gains into tomorrow's congressional testimony by Chair Powell

Atlanta Fed President Raphael Bostic

USD: Lockdown

FX market volatility remains suppressed, given no sign of major central banks adjusting policy rates anytime soon. Catching our eye yesterday were comments from Atlanta Fed's Raphael Bostic that the threat of 'pent-up exuberance' in the business sector could cause a return of inflation should the Federal Reserve cut too quickly. Bostic reiterated a view of a first cut in the third quarter and then a pause to see how businesses and markets responded. While Bostic is a known hawk, his remarks serve as a reminder that the Fed may not pursue its typical easing cycle of consecutive rate cuts with there being no crisis. Two-year USD swap rates rose on these comments late yesterday as the market shifted to pricing a more gradual easing cycle. For reference, the forwards market now prices a terminal rate for the Fed easing cycle at 3.50% in two years, about 50bp higher than what was priced in late December.

As an aside, Bostic's use of the term 'exuberance' recalled the phrase 'irrational exuberance' used by Fed Chair Alan Greenspan in December 1996. Then, he questioned whether the stock market had come too far, too fast. The S&P 500 then doubled over the next three years.

Bostic's comments feed into the prevailing view that the Fed is in no rush to cut rates, and that this view will likely be echoed when Fed Chair Jerome Powell testifies to the House Financial Services Committee tomorrow afternoon. We doubt the market will want to try selling dollars before that testimony. Equally, the overnight news from China suggests local authorities will struggle to reach their 5% growth target and provides no fresh bullish impetus for non-dollar currencies.

We doubt today's US ISM Services data for February will be a major market mover, although a repeat of the strong January release would be dollar-positive. And we see DXY continuing to find support under 104.

Chris Turner

EUR: Downside risks into Thursday

EUR/USD remains supported above 1.08, and the risk environment remains positive, judging from this year's global equity market performance, as well as the rallies in gold and Bitcoin. We do fear that EUR/USD has a little downside later this week on Thursday's European Central Bank risk. Our latest ECB Cheat Sheet illustrates where we see risks of a weaker euro as the ECB lays out the conditionality of a June rate cut. Combined with Fed speeches this week, our bias is that EUR/USD ends the week near 1.0800. The eurozone data calendar is light today, and we doubt the January PPI release is a market mover.

Elsewhere, we are glad to see EUR/CHF trading over 0.96. Interestingly, the markets are still pricing a 53% chance of a Swiss National Bank (SNB) rate cut when it meets on 21 March. That may seem unnecessary now given that the real Swiss franc has corrected lower – yet the SNB now has inflation under target over its forecast horizon, suggesting there is still a possibility of a move.

Chris Turner

JPY: Notes from Japan

We were visiting customers across Asia last week and were fortunate enough to spend some time in Tokyo. Views from local institutions suggested that the spring wage round, the Shunto, would come in on the strong side – perhaps even above 4% year-on-year. We hear that this data will be released on 15 March. Most felt that the Bank of Japan would be able to hike rates at the 26 April policy meeting. The strong consensus, however, was that the BoJ would move very carefully and that the yen would struggle to sustain a strong rally given the overwhelming force of the carry trade environment.

On BoJ FX intervention, there was also a consensus that 155 in USD/JPY was some kind of line in the sand for Japanese authorities and that intervention would be seen should USD/JPY make it that far.

Chris Turner

CEE: Czech wages tell us more about possible easing in the labour market

This morning in Hungary, the second estimate of GDP for the fourth quarter (including the breakdown) was published. More interestingly, the Czech Republic's fourth-quarter payroll data will be released later today. The Czech National Bank (CNB) expects a 1.3% YoY real contraction, while the market expects 1.1%. However, the bar is likely high given that the central bank is turning its attention elsewhere these days. On the other hand, the labour market in the Czech Republic is showing some signs of easing for the first time in several years.

In the CEE-3 region markets, the CZK has been the least volatile currency over the past two weeks, bouncing between 25.300-400 EUR/CZK, and we don't expect much change here for now. On the other hand, we have the HUF, which in turn has been leading in terms of volatility in the region for the last few days, driven more by the discussion between the government and the central bank on where the terminal rate should be in Hungary. The markets are currently pricing in slightly above 5% in the one-year horizon, and this is in line with the Economy Minister's comments yesterday. Over the longer term, the market is overshooting yesterday's comments about 4.5% at the end of 2025. EUR/HUF welcomed the pressure for more rate cuts with another move up and closed yesterday at 396, the highest in almost a year. As we mentioned yesterday, the higher interest rate differential following the latest National Bank of Hungary (NBH) decision should support a stronger HUF, but for now it seems that the local discussion will be the main driver for a while.

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