

## FX Daily: Fiscal rigor pledge is calming sterling market

The pound and gilts have found some respite after a substantial – albeit orderly – selloff. The UK Treasury's pledge to stick to fiscal rules means more potential pain for sterling down the road, but it should allow some stabilisation in the short term. Elsewhere, we see upside risks for the dollar on the back of robust payrolls



UK Chancellor Rachel Reeves

### USD: Payrolls should keep Fed cautious

The December US jobs report is released today and consensus is for a 138k payroll print and unchanged 4.2% unemployment rate. Our economics team also expects 4.2%, but is flagging room for a surprise on the strong side. Our house projection is 160k.

We think the balance of risks is tilted to the upside for the dollar today, as robust jobs figures could prompt markets to price out a March cut and potentially push the first fully-priced move beyond June. We would still argue that with inflation concerns back on the rise – although the Fed speak has been quite heterogeneous on that topic – next Wednesday's CPI report could have deeper market ramifications.

In the event of a (moderate) disappointment in today's job figures, the dollar should take

a positioning-readjustment hit, but dollar longs may simply be rebuilt at better levels ahead of key upcoming data releases and Trump's inauguration on 20 January.

Employment data for December is also released in Canada today, where expectations are for a slowdown in hiring to 25k and another tick-up in unemployment to 6.9%. The impact on CAD would likely be short-lived as the currency is almost entirely trading on the back of the perceived risk of a US-Canada trade war, and how that can be impacted by the new prime minister. At this stage, consensus seems to be building around two candidates: former Finance Minister Chrystia Freeland and former Bank of Canada/Bank of England Governor Mark Carney. The latter would – in our view – be better received by markets as Freeland has been on contentious terms with Trump.

*Francesco Pesole*

## 📉 EUR: Lots of negatives in the price

EUR/USD undervaluation has once again exceeded 2.5%, as FX and short-term rates dynamics have continued to diverge. When the EUR:USD two-year swap rate gap was last at the current -175bp (November), EUR/USD was trading around 1.05.

This tells us that markets are pricing a good deal of negatives into the euro at this stage, and perhaps the euro may be penalised less than other G10 currencies should US payrolls come in strong today. EUR/USD can find decent support at 1.0250 or at the 2 January low of 1.022.

One positive development for the euro has been the correction in TTF gas prices, now at 45 EUR/Mwh after having touched 50 EUR at the start of January. Markets have seemingly been reassured by forecasts of milder weather in Europe and robust LNG supply from the US. There is also some ongoing discussion within the EU – championed by Slovakia – to potentially reactivate the Ukraine gas pipeline.

*Francesco Pesole*

## 📉 GBP: UK Treasury eases market nerves

The 10-year gilt stabilised around 4.80% yesterday, which has allowed the pound to partially recover after hitting a 1.224 low yesterday morning. What has helped calm market nerves was a comment by a top UK Treasury official who claimed “meeting the fiscal rules is non-negotiable”. In practice, this means that since the rise in yields has eroded the fiscal headroom, Chancellor Rachel Reeves is more likely to deliver some fiscal consolidation should the updated OBR forecasts (released 26 March) show the government is not on track to meet the fiscal rule. That consolidation means higher taxes or lower spending – with the latter generally deemed more likely at this stage.

The market seems to be acknowledging the Treasury's reiterated fiscal pledges and this has prevented the gilt and pound selloffs from becoming disorderly. As discussed in this [note](#), this is not a sovereign crisis, and the rise in yields is – so far – justified.

This suggests we can expect some short-term respite for the pound. In the coming months, we expect fresh pressure on GBP on the back of much larger easing by the Bank of England compared to pricing; which may coincide with the fiscal tightening mentioned above. Today, the US leg could add some extra pressure on GBP/USD, but if gilts have another quiet session, the pair should attract buyers in the 1.225-1.230 area.

Francesco Pesole

## ➔ CEE: Relationship decoupling

The end of the week, as in the previous days, does not have much to offer in the CEE region calendar. This morning saw the release of retail sales and final 3Q GDP numbers in Romania. Otherwise, we won't see much else today. Attention turns to the global story with US labour market numbers. Yesterday CEE FX showed a remarkable turnaround from weakness in the morning to further gains in the afternoon.

More interesting in our view is the decoupling of some market relationships, particularly rates and FX, which have been very strong in the region in recent weeks. In particular, we saw a strong divergence in Poland's zloty and the Czech koruna yesterday and both currencies seem too strong to us. Of course, today the US market will lead the market. For the zloty, next week's central bank meeting may provide further downside support for EUR/PLN. Also, as the pair remains within our preferred range of 4.260-4.280, we don't see strong reasons to take a contrary position. In the case of EUR/CZK we see more of an upside bias and any levels closer to 25.00 may be interesting for the market to go short CZK ahead of inflation numbers and some Czech National Bank headlines next week given the hawkish market pricing.

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