

FX Daily: Geopolitics sees pro-risk trades unwind

US data and Fed commentary is keeping the dollar bid. At the same time, geopolitics and reports that China is preparing to increase its support for Russia are also seeing an unwind of 2023 global recovery trades. February and March are seasonally strong months for the dollar and 4.50% overnight deposit rates can keep the dollar supported a little longer



Incoming Bank of Japan Governor Kazuo Ueda

USD: Dollar strength is not just a Fed story

It has been quite surprising to see USD/CNH move back above the 6.90 area and also see USD/KRW stay bid above 1300. The 2023 narrative was meant to be about US disinflation, China re-opening and \$/Asia playing a major part in the broad dollar decline. That has not been the case. Away from the US disinflation/Fed story, the rally in USD/Asia and USD/CNH may also be down to a re-appraisal that: a) Asian trade surpluses may be harder to come by given the slowdown in Europe and the US, plus b) geopolitics creeping into investment decisions. For example, [reports overnight](#) suggest that China may be preparing to up its support for Russia consistent with recent briefings out of Washington. The fear of an escalation in US sanctions may be prompting investors to re-appraise some of their investment holdings along geo-political lines.

This comes at a time of the year when the dollar is seasonally strong (February and March) and the bar to put money to work outside of 4.50% yielding overnight dollar deposits is not particularly low. Away from geopolitics, yesterday's US fourth quarter GDP revision saw the core deflator revised up to 4.3% annualised, from the 3.9% originally reported, and today should see the January core PCE deflator at a sticky 0.4% month-on-month. In other words, the US disinflation/bearish dollar narrative will find little from today's data.

DXY looks like it can continue to press 105.00 and should USD/CNH trade back up to 7.00 on geopolitics, we could be looking at 105.60/106.00 on DXY.

Chris Turner

📉 EUR: Eurozone core inflation strikes new high

Yesterday's revisions to eurozone January inflation saw core inflation revised to a new cycle high of 5.3% year-on-year. No wonder ECB officials such as Isabel Schnabel are keen to dispel any ideas that the disinflation process has started. And a core view slowly permeating through the market is that the ECB has perhaps another 100bp+ of tightening to do, but crucially will be leaving rates at those high levels throughout a large chunk of 2024. This should be a key factor in keeping EUR/USD supported on a multi-quarter view.

The eurozone calendar is light today, but given the dollar bid on the back of US data/geopolitics, the EUR/USD bias looks to a press of 1.0575 support and a potential move to 1.0500.

Chris Turner

➡ GBP: A good week for UK data

Following on from Tuesday's strong PMI release, the UK outlook has received another boost today in the form of a big jump in GfK consumer confidence. This has now returned to levels not seen since last April. At the margin, this will make the Bank of England's life harder as it seeks to cool aggregate demand to soften inflation. Markets are now quite comfortable in pricing the BoE's Bank Rate at 4.50% at the end of this year – pricing 25bp hikes in March and May.

Slightly better growth prospects, sticky inflation and some further monetary tightening are the story across the US, the eurozone and the UK at the moment – suggesting bilateral FX rates do not need to move too much. This has seen three-month GBP/USD implied volatility drift under 10% and would tend to favour more modest moves in the spot. We think support levels at 1.1850/1950 may hold over the next couple of weeks. BoE dove Silvana Tenreyro speaks at 1730CET today.

Chris Turner

➡ JPY: Few bombshells from BoJ Governor nominee

The Japanese yen event risk has been overcome today in the form of testimony from the nominee Bank of Japan (BoJ) Governor Kazuo Ueda. The yen and Japanese government bond (JGB) yields moved little on his remarks that a dovish policy setting was still appropriate, but that normalisation would be needed were the BoJ to conclude that inflation had achieved 2% on a stable basis.

The forward market for 10-year JGB yields does, however, price a further widening of the 10-year

JGB band (+/- 50bp around zero) within the next three months. And the FX options market prices volatility around the key BoJ monetary policy dates of 10 March and 28 April.

Our view is that this corrective dollar bounce could carry USD/JPY up to the 136/137 area over the next couple of weeks. But assuming that we are correct with the US disinflation story dominating again in the second quarter, USD/JPY should be back towards 125/126 into the summer.

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