FX Daily: gilt measures worth only temporary GBP relief

It's a busy day ahead in FX markets. The highlight should be another 25bp cut from the ECB, but we'll get plenty of fourth-quarter GDP data from the US and Europe. Elsewhere, we think this week's measures from the Bank of England to support the gilt market will provide only temporary relief to sterling – which we expect to head lower over the coming months

UK Chancellor Rachel Reeves delivers a speech on growth at a factory near Oxford on 29 January 2025

USD: Fed does not move the needle

As discussed in yesterday's FOMC review, the dollar failed to hold very modest gains from the initially hawkish-sounding FOMC statement. Subsequent clarification comments from Chair Jay Powell through the press conference saw both USD rates and the dollar hand back those gains. This leaves the market looking for two 25bp cuts this year – one in June and one in December – and awaiting both US data and the tariff story for their next big cues. Those dovish on the Fed will be hoping for some softer core PCE inflation data tomorrow (perhaps even a 0.1% MoM reading?) and expecting large and negative benchmark payroll revisions early next month to change the narrative on a robust US labour market.

Yet as the Bank of Canada concluded in two great articles in its Monetary Policy Report released yesterday, tariffs could be a massive game-changer. It calculated that 6% of the 7% rise in USD/CAD since October was down to a risk premium. Investors await tariff news either this weekend or, failing that, in April after the Commerce Department and the US Treasury conclude their review into why the US runs persistent trade deficits.

Elsewhere we note that Nvidia is struggling to reclaim much of Monday's sharp sell-off on the DeepSeek news – where most seem to be concluding that DeepSeek's progress could be good for productivity gains yet bad for those tech and energy companies in which those AI-centred profits are concentrated. In early Europe, S&P 500 futures are marked modestly higher after a mixed set of earnings results from MSFT, Tesla and META overnight.

Today the US focus should be on a reasonably strong fourth-quarter GDP release, very much driven by strong consumption. This should prove another tick in the box for US exceptionalism and could see DXY heading back to the 108.20 or even 108.50 area – depending on ECB developments today.

Chris Turner

EUR: Dovish ECB could weigh on EUR/USD

It is a busy day for the European calendar dominated by GDP releases and the ECB meeting. France has just released a weaker-than-expected fourth-quarter GDP reading of -0.1% QoQ. Consumption and business investment were the weak links. Remember, the threat of trade tariffs is normally a negative for business investment – something the IMF has modelled. Let's see how the German and Italian numbers fare at 10CET and then the provisional eurozone release at 11CET. Here the consensus for eurozone fourth-quarter growth currently stands at 0.1% QoQ, with seemingly downside risks.

Today's main event, however, is the ECB meeting – rate announcement 1415CET. A 25bp cut in the deposit rate to 2.75% is nailed on and instead the focus will be on ECB President Christine Lagarde's press conference. We present our EUR/USD scenario analysis here, but see some downside risks if the market believes there is a chance of the ECB taking policy below neutral. Today's main topic of discussion could very well be the neutral rate, which is generally estimated to be around 2.25%. For reference, the low point in the ECB easing cycle was priced near 1.50% in early December and is priced at 2.06% today. Our eurozone team think the ECB can cut rates to 1.75% in the second quarter, so clearly there is some downside for short-dated EUR rates and the euro if we're right.

EUR/USD should be driven by events in Europe today, with a slight bias to the 1.0345/55 area should Lagarde sound quite dovish.

Chris Turner

GBP: Gilt and fiscal story very much in play

The UK fiscal story and what it means for UK asset markets remain very much in play. UK Chancellor Rachel Reeves wants to change the narrative from painful tax rises for businesses to UK growth opportunities. That was the purpose of major policy announcements in Oxford yesterday. Those announcements could also be seen as an effort to sway the thinking of the Office of Budget

Responsibility (OBR) as it scores the government's policy agenda ahead of a March review. Recall that the OBR still has relatively high UK growth forecasts up to 2030 (especially for this year). And the government will be doing its utmost to persuade the OBR not to revise those forecasts down – which would only make the UK's fiscal position worse. We suspect the government will have to announce some fiscal consolidation in March, largely through real-time spending reductions in the later years of the forecast cycle.

The relevance of the above is that it is also an effort to restore confidence to the UK gilt market. Another effort in this direction was the Bank of England's announcement on Tuesday of a new contingent facility – the CNRF – to lend cash to Non-Bank Financial Institutions (NBFIs) in the event of dislocation in the gilt market. This will be widely welcomed by the NBFI industry, although it seems less generous than the Fed's Bank Term Funding Progarmme, which lent cash against eligible collateral, without haircut, for a year. The BoE's CNRF tool only gets fired up if the BoE sees a crisis in the gilt market and seemingly only lends funds for one to weeks.

While these efforts to restore confidence are very welcome – and have helped the sterling trade-weight index recover about 1% from lows earlier this month – we still feel sterling is vulnerable. Fiscal consolidation in March and a drop in services inflation through the second quarter should lead to a 100bp BoE easing cycle this year. This compares to just 68bp of easing priced by the market today. We see no reason to change our end-year GBP/USD and EUR/GBP forecasts of 1.19/20 and 0.85 respectively.

Chris Turner

CEE: GDP season kicks off

The 4Q24 GDP data in the CEE region starts today. In Hungary, we expect data to be somewhat ambivalent. There will be positive quarter-on-quarter growth, which means that the technical recession in Hungary is quickly coming to an end. However, the growth rates will be pedestrian, so it will be more of a correction than a major upturn in economic activity. Given such a sluggish final quarter, we see GDP growth averaging 0.5% in 2024. In Poland, we expect 2.8% YoY. Consumption improved, but industry was still broadly stagnant and construction was in decline. In 2024 as a whole, we see economic growth at 2.7%.

As for the speakers, we could potentially hear something from the Czech National Bank today before the blackout period begins, but we have already heard plenty, including the Governor and Deputy Governor confirming the high chance of a rate cut next week, which is also our base case. In Hungary, a speech by the Minister of Economy is on the calendar.

Barring any major surprises in the GDP data, the driving force for the CEE should be yesterday's Fed and today's ECB. A mildly hawkish Fed should again put some pressure on EM markets, but CEE currencies appear to remain confident. We still maintain a negative bias on the CZK and believe the CNB rate cut will drive EUR/CZK higher, closing the FX/rates gap and heading towards 25.350-400. EUR/PLN remains an enigma where rates also point to higher levels and the EUR/USD bounce should be a reason for PLN to weaken. However, the National Bank of Poland remains the most hawkish central bank in the region, which may keep the PLN stronger for longer. Overall, we have a negative bias here as well, but conviction remains low. EUR/HUF is trending lower as we expected, and as we noted in the NBH review, the central bank's hawkish tone here is positive for FX. Although we expect a move back higher here as well. For now, however, we believe HUF will stay stronger for some time.

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