

FX Daily: Growth stories back in focus

It's PMI day, and we think the euro could benefit from the reinforcement of its growth story after a period of few domestic drivers. With the Fed's hawkish rate repricing having gone a long way, we suspect the USD rally may soon run out of steam, even though risk-off may delay a downtrend. Elsewhere, we expect a hawkish 50bp RBNZ hike, but dovish risks have risen



Yesterday's visit by President Joe Biden to Kyiv reiterate the now well-established notion that this will be a long war

➔ USD: Supported by risk-off mood, but rally looks tired

After a very quiet start to the week in FX due to a US holiday, we should start to see some action today. Yesterday's visit by President Joe Biden to Kyiv and the pledge for more support to Ukraine don't have clear implications for markets in the near term, but probably reiterate the now well-established notion that this will be a long conflict. The ramifications for the global economy can still be quite deep, especially in neighbouring Europe, but energy prices have been the main transmission channel from the war to the market, and TTF trading around 50 EUR/KWh is allowing markets to turn a blind eye to longer-term risks.

We argued in yesterday's FX Daily how this could be the week where the dollar rally starts losing some steam. The main reason for this is that the recent hawkish rhetoric and strong data have likely been absorbed by now and a further hawkish repricing in Fed rate expectations (currently

embedding a 5.40/45% peak rate) is looking increasingly harder. We think that at this stage, it may be mostly down to external factors – like news from Ukraine/China or a general deterioration in risk sentiment – to push the dollar even higher.

The key event on the Fed front this week, the FOMC minutes, may not match the hawkish tone we heard after the strong jobs and inflation data released after the meeting. PMIs will be watched in the US like in the eurozone, but the rebound in other surveys already favoured a positive re-rating in US growth expectations and may have set the bar quite high for a major positive surprise to lift the dollar.

Still, signs of deterioration in the global risk sentiment this morning suggest today might not be the day for the start of a dollar downtrend, but – equally – we struggle to see DXY extend the recent rally to 105.00 and we could instead witness the start of a decline again towards 102.50-103.00 in the coming days.

Francesco Pesole

EUR: A reminder of the improved growth outlook

The euro has been left without strong domestic drivers on the data front over the past week, so today's PMIs will be watched quite closely. Consensus is leaning in favour of some modest improvement in both manufacturing and service gauges, and investors might see this as an opportunity to re-enter strategic medium-term long-EUR positions now that the dollar correction seems to be losing momentum.

Instability in global risk appetite today may delay the beneficial effects on EUR/USD today, but we still see the balance of risks tilted to the upside for EUR/USD in the coming days, and a return to the 1.0750-1.0800 range seems possible.

Elsewhere, it is a very busy week in Sweden. Despite some easing in inflation expectations in the Prospera survey released this morning, yesterday's core CPI inflation print came in hotter than expected at 8.7% (rising from 8.4%), and EUR/SEK dropped on expectations of more Riksbank tightening. While this fits our view for a recovery in the krona over the course of the year, we warn against celebrating too early. Remember that the slump in SEK was originally triggered by concerns about the Swedish economic and housing situation, and while more Riksbank tightening helps SEK in the near term, it raises the risks of a black-swan scenario materialising down the road. We think activity data and the outcome of wage negotiations can still generate significant volatility in the krona, and a sustainable move below 11.00 in EUR/SEK still looks premature.

What the Riksbank surely wants is a stronger SEK, and we have now gotten used to hearing references to the currency from many speakers. The minutes from the latest meeting, released yesterday, did all but confirm that there is a strong hawkish direction at the Riksbank. We have long argued how maintaining such rhetoric is likely the best way to navigate the current policy challenges in Sweden. We'd be surprised to hear any dovish hint from the two speakers today (Floden and Ohlsson) or by Governor Erik Thedeen tomorrow.

Francesco Pesole



GBP: Looking unlikely to sustainably outperform EUR

The PMIs will also be released in the UK this morning, and the consensus seems to be looking at an improving outlook here as well. Still, UK PMIs should continue to fall below the eurozone ones and therefore continue to point to the UK's relative economic underperformance.

Ultimately, we struggle to see the pound consistently strengthening against the euro, especially as we expect the Bank of England to deliver only one last 25bp hike in March, while markets are partly pricing in further tightening after that. EUR/GBP may stay range-bound or climb gradually at this stage.

Francesco Pesole

NZD: We expect 50bp by RBNZ, but watch the cyclone risk

The Reserve Bank of New Zealand (RBNZ) announces monetary policy at 0100 GMT tomorrow and we are aligned with the consensus call for a 50bp rate hike – as discussed in [our meeting preview](#). This is its first monetary policy meeting since November, and policymakers will need to take note of the deterioration in activity indicators, inflation having undershot the Bank's projections, and a housing market that has remained under pressure.

All those factors are enough, in our view, to convince the RBNZ to slow the pace of tightening from 75bp to 50bp, but there is probably little advantage in offering dovish signals to the market. Such signals would not just come with a smaller – 25bp hike – but also by revising the peak rate projections lower, which are currently at 5.50% in mid-2023.

We have increasing doubts that the 5.50% level will be reached at all (rates are at 4.25% now). Despite the house price correction having largely been in line with RBNZ projections, lower-than-expected inflation would encourage stopping hikes – and hopefully the housing slump – earlier. It is, however, too premature to review those rate projections lower, in our view, at least until there is more conclusive evidence that the disinflation process has started.

There is one key risk to our call though: the impact of the cyclone in New Zealand. This has triggered growing speculation that the RBNZ will only hike by 25bp or even pause, and is probably behind the drop in NZD/USD to 0.6200 this morning. Admittedly, this downside risk has become more material now, but we stick to our call for a hawkish 50bp hike by the RBNZ, and we think this will lift the New Zealand dollar tomorrow. However, we think this may be one of the last times the RBNZ has a direct positive impact on NZD as many factors suggest a dovish pivot will come soon.

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