FX Daily: Hard to fight the dovish narrative

The week ahead is a busy one for financial markets, including key central bank meetings in the UK and US, key data releases (eurozone inflation, US NFP) the US Treasury quarterly refunding announcement and Big Tech earnings. Cross-market volatility is low, favouring the carry trade, but the case to move out of high-yielding dollars is far from compelling

USD: Gearing up for a big week

The dollar has been the strongest performer across the G10 and emerging market currency blocs this year. This is probably down to US growth holding up well. This means that the Fed need not rush into rate cuts. Additionally, there is a far from compelling investment case in the rest of the world. For example, fourth quarter GDP data for 2023 should this week confirm the eurozone's technical recession, and the news out of China has hardly filled investors with a sense of confidence.

We identify four big stories in the US this week. The first is Wednesday's FOMC meeting. We are going with the view that the Federal Reserve will push back against the dovish narrative, although we realise this is a hard sell to financial markets this year. Next is Wednesday's Quarterly Refunding announcement from the US Treasury. Can the US Treasury avoid the banana skin of issuing too much at the longer end of the curve? The risk here is of higher US Treasury yields and weaker equities should the US Treasury get this wrong. Next, we have quarterly earnings from four of the 'Magnificent Seven'. Tuesday and Thursday are the release days here. And the week concludes with what should be another strong NFP release, again confirming that the Fed should not be in a rush to get rates back to neutral.

With seasonals staying strong for the dollar through January and February, we think it is too early to make the case for a resumption of the dollar bear trend just yet. 103.00-104.00 could well be the DXY range this week.

Chris Turner

EUR: A soft week for eurozone activity and inflation data

The euro is edging towards the softest level of the month as markets hold onto the possibility that the European Central Bank could ease in April. Economists expect that the ECB will want to see the Eurostat wage data release at the end of April, before considering a first move in June. However, the market prefers to listen to the ECB doves, the data showing that activity is soggy and that inflation continues to fall further. The latter will receive more support this week in the form of fourth quarter of 2023 eurozone GDP data confirming a technical recession.

Plus, Wednesday and Thursday will see the national and the eurozone January CPI data. For the eurozone, we forecast a sub-consensus headline reading of 2.7% year-on-year and an on-consensus core reading of 3.2% YoY – the lowest since March 2022. Such an outcome can keep two year EUR:USD swap differentials on their wides near -120/125bp and keep EUR/USD near 1.08, our end of quarter forecast.

1.0800-1.0875 may be today's EUR/USD range.

Chris Turner

GBP: A more difficult week for sterling?

Within the G10 space, sterling has performed best against the strong dollar so far this year. Perhaps helping it has been the lack of communication from the Bank of England (BoE) given that investors have been keen to jump on any dovish hints from central bankers this year. However, there could be some dovish hints at Thursday's BoE policy meeting, where the Bank could drop its tightening bias (both in its voting pattern and statement).

Even though it looks like we should see a soft week for the euro, a less hawkish BoE should see EUR/GBP hold strong support at the 0.8500 area. Very low implied volatilities suggest GBP/USD moves will not be large, however. 1.2650 looks the risk into Thursday.

Chris Turner

CEE: NBH cuts rates while Hungary is main topic of EU summit

Today's calendar in the region is empty. The main point of interest here will be the POLGBs auction, which will again test market demand after a significant increase in supply this year. Tomorrow in the Czech Republic, fourth quarter GDP data will be released, where we should see very modest economic growth. Also on Tuesday, the National Bank of Hungary (NBH) will hold a meeting. We expect a 100bp rate cut in line with expectations. However, the risk still remains of a weaker HUF these days. Wednesday will see the release of GDP data in Poland. On Thursday, we will see the Czech Republic's state budget result for January and PMIs across the region for January.

We will also continue to monitor the Czech National Bank (CNB), which begins a media quarantine on Thursday. We should see a few statements from the board before then. On Thursday, there will be a key EU summit, where the main topic should be the financing of Ukraine – which could be a tricky moment for Hungary. In Poland, the state budget could be approved by the president this week.

CEE FX saw quick moves in a rather weaker direction last week and our view for this week remains rather bearish. The main focus will be EUR/HUF, which is key for the NBH meeting on Tuesday. We believe levels above 390 would turn the central bank more cautious and levels above 395 would imply a hard stop for a 100bps move and only 75bps. As we mentioned last week, higher market rates should keep the HUF under control. But political noise on the local or EU side could push EUR/HUF higher again. On the other hand EUR/PLN should head lower towards 4.350 following strong paying flow in rates and the budget approval could at least for now bring a break in the political tensions. We continue to see EUR/CZK in the 24.700-800 range.

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