

FX Daily: Hawkish Powell lends his wings to the dollar

Fed Chair Powell opened the door to a 50bp hike and hinted at a higher peak rate in his semi-annual testimony. This was a reminder that picking the top in the dollar rally remains too risky. Short-term volatility and weak sentiment can drive EUR/USD below 1.0500 into Friday's US jobs data. Elsewhere, we expect the BoC to stay put today, but no rates pushback



Jerome Powell delivers semi-annual testimony to the US House today

Join our economists and strategists for a live discussion of the upcoming US Federal Reserve, European Central Bank and Bank of England meetings. We'll run through our expectations and what the meetings could mean for financial markets.

Tomorrow, 09 March 2023, 15:00-15:40 CET, via MS Teams.

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⬆️ USD: Powell's hawkishness boosts the dollar

Yesterday's semi-annual Senate testimony by Federal Reserve Chair Jerome Powell surprised on the hawkish side and triggered a large dollar rally. As discussed by our US economist [here](#), Powell hinted both at a higher peak rate ("that the ultimate level of interest rates is likely to be higher than previously anticipated") and opened the door for a return to 50bp hikes ("we would be prepared to increase the pace of rate hikes"). This marked another key step in a month-long process of re-pricing rate expectations after the February FOMC press conference had led markets to bet on an early end to the tightening cycle. The two-year USD swap rate has now risen by a full 100bp since the 4.32% 2 February low, and DXY is trading at the November highs.

The question now is, can the Fed continue to push the dollar higher? The short answer is yes, essentially because even assuming markets won't price in a higher peak rate than the current 5.75%, a 50bp move in March isn't fully priced in (40bp embedded in the OIS curve) and there is ample room to scale back rate cut expectations for end 2023 and early 2024.

That is, however, not a given. We have observed high "elasticity" of Fed communication to data: strong inflation, jobs and activity numbers have allowed a radical hawkish re-tuning in the FOMC rhetoric. Our economics team has recently been highlighting how seasonal and weather-related factors may have helped paint an excessively rosy picture for the US economy, and some reality checks may well be on the cards. For example, [this week's payrolls may come in weaker than expected](#).

One could argue that the Fed's communication may not be as "elastic" on a potential dovish re-tuning if the data disappoints, and members will prefer to err on the hawkish side to keep financial conditions tighter for longer. We agree, and it is hard to imagine a straight-line downward path for the dollar from these levels even if data starts to soften (barring substantial data weakness). However, we keep warning against building bullish-dollar views beyond the short-term: markets may be underestimating the risk of a hard landing for the US economy, and we remain of the view that a broad-based dollar decline is only delayed (more in our [latest FX Talking](#)).

For now, volatility should remain elevated, and the dollar's balance of risks is moderately tilted to the upside ahead of Friday's jobs numbers. Today, we have the second round of Powell's testimony (to the House), a speech by Thomas Barkin and the release of the Fed's Beige Book. On the data front, ADP jobs figures will be published - they have not had good predictive power for official data - as well as JOLTS jobs openings. DXY may well break above 106.00 before Friday, although we expect a correction with the NFP release.

Francesco Pesole

⬇️ EUR: 1.0500 can be broken today or tomorrow

The Powell-led EUR/USD drop yesterday means that the next key support for the pair is now 1.0500. That is a key benchmark level for the pair, and the elevated volatility - combined with deteriorating risk sentiment - raises the chances of a break lower. Such a break lower would however continue to mirror primarily dollar strength as opposed to a lack of faith in the euro's fundamentals.

Let's remember that the euro is the best-performing G10 currency after the dollar in the past month, and we doubt fresh idiosyncratic EUR weakness is on the cards. The European Central

Bank continues to propel rate expectations higher, and the recent inflation readings give President Christine Lagarde all the incentive to sound hawkish when she delivers another 50bp hike next week. Incidentally, the latest PMIs have been pointing to an improved eurozone outlook.

The euro hasn't got many weapons to fight the dollar strengthening at the moment, though. The eurozone's data calendar lacks market-moving releases and a speech by Lagarde today does not seem to have much to do with monetary policy. Two of the most dovish ECB members – Ignazio Visco and Fabio Panetta – are the other scheduled speakers today, so expect little support to the euro on that front. Today and tomorrow will offer the best opportunity – in our view – to press below 1.0500, while we favour a EUR/USD rebound on a softer US jobs report on Friday.

Francesco Pesole

⬇️ GBP: Still upside risks for EUR/GBP

EUR/GBP faces upside risks every time the Fed's hawkish messaging hits risk sentiment: this is because the pound has a higher sensitivity to risk sentiment. Incidentally, at the current juncture, the euro is looking more attractive than the pound, thanks to the ongoing hawkish repricing in ECB rate expectations and a more encouraging domestic outlook.

Like the euro, the pound is lacking internal drivers this week, but in light of the deterioration in sentiment and the euro's better fundamentals, we continue to see moderate upside risks for the pair, with a break above the near 0.8922 17 February high setting the next key resistances at 0.8950 first, and the 0.8970 February high then.

Francesco Pesole

➡️ CAD: BoC to hold, but should leave door open for hikes

The Bank of Canada announces monetary policy today, and is widely expected to keep rates unchanged. As discussed in our [BoC preview](#), the "pause" narrative was recently endorsed by disappointing growth and slower-than-expected inflation. However, the jobs market has remained tight, and data show that there are over 800k more employees in Canada than before the pandemic.

Some cooling off in the jobs market will likely be required to make the BoC relaxed with some re-easing of financial conditions, and for now, it's likely that Governor Tiff Macklem wants to keep the door open for more tightening if needed, also because inflation remains significantly above target. There are 25bp of tightening in the CAD OIS curve which is mostly a spillover of higher Fed rate expectations: unlike what we observed in Australia, where the central bank's chief pushed back against further tightening, Macklem may not sound uncomfortable with the current market pricing.

At the same time, more rate hikes in Canada will hardly be priced in without clear hints of a resumption of the tightening cycle. This means that CAD may see – if anything – only some short-lived benefits from the BoC announcement today, since the BoC pause makes the loonie more vulnerable to USD appreciation compared to other currencies that can count on hawkish central banks.

We continue to expect a return to 1.3000 by the second half of the year, but that would almost solely be a matter of improved risk sentiment and a weaker USD, rather than a stand-out CAD

outperformance.

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