

FX Daily: Hawks in the ascendancy

It is a familiar story in FX, but the strong run of US price and activity data has provided a tailwind to Fed hawks. Yesterday it was the turn of Fed's Mester and Bullard to put the idea of more aggressive 50bp rate hikes back on the table. We have another couple of Fed hawks speaking today, Barkin and Bowman, suggesting the dollar can hold gains



The Fed's James Bullard said he would not rule out supporting a half-percentage-point hike at the March meeting

USD: First quarter of 2023 is proving to be the push-back quarter

The dollar continues to quietly reclaim some of the heavy losses seen since last October. DXY has now reclaimed about a quarter of that sell-off. The move has clearly been driven by the re-assessment of the Fed cycle, where the 'higher for longer' camp is in the ascendancy. Yesterday, it was the turn of Loretta Mester and James Bullard to outline how they had favoured a 50bp hike earlier this month instead of the 25bp which was delivered. Equally, they both implied they could support a 50bp hike at the 22 March meeting.

Their comments coincided with an above-consensus US January PPI release and pushed 10-year US Treasury yields a further 6-7bp higher. At 3.89%, the US 10-year yield is now the highest since November. The higher rates for longer thesis has also seen some substantial re-pricing of the Fed

curve this month where market pricing for the December 2023 Fed Funds rate has risen to 5.10% from 4.35%.

Financial markets are making these substantial adjustments to the Fed cycle – i.e. markets are listening to the Fed hawks – because US activity and price data are coming in stronger than expected. We think the better activity data is partly weather-related and had always thought that the next leg of the US disinflation story would be in the second rather than the first quarter. In short, we think the current dollar rally is probably a correction to an underlying bear trend in 2023.

This 1Q23 dollar correction may have a little further to run, however. Today we will also hear from Fed hawks Thomas Barkin and Elizabeth Bowman, plus receive an update on January import prices. We see a scenario where DXY continues to edge up to 105.00, with outside risk this quarter to strong resistance at 106.50 (about 1.8% above current levels), which may then prove the best dollar levels of the year. The next big input to the story will be the FOMC minutes released next Wednesday.

Chris Turner

➔ EUR: Temporary downside to EUR/USD

The hawkish re-pricing of the Fed curve dominates markets and even though eurozone money market rates have risen too, the two-year EUR/USD swap differential has widened back out to levels last seen in mid-December. This now stands at -150bp having narrowed to -110bp at the start of this month. Arguably this spread should not narrow in too much more (unless the market thinks that Fed Funds will end the year near 5.50%), meaning that EUR/USD may not have to fall too much more. We would, however, say the direction of travel is to the 1.0450/1.0500 area, which may be the strongest dollar level of the year for eurozone corporates.

There is not too much on the eurozone calendar today apart from the December current account figure and the market seems to be ignoring yesterday's comments from ECB dove, Fabio Panetta, favouring the ECB to move in 25bp rather than 50bp increments. Today we hear from ECB's Francois Villeroy (1230CET), seen more as a centrist these days.

Chris Turner

➔ GBP: BoE slowdown softens the pound

In contrast to the hawkish Fed rhetoric yesterday, comments from Bank of England chief economist Huw Pill pointed towards the BoE shifting towards a slower pace of tightening. As mentioned yesterday, we look for one final 25bp BoE hike to 4.25% next month. The comments have seen sterling very marginally underperform – consistent with our preferred view of EUR/GBP drifting into a 0.89/90 range this year.

Away from central banking, the UK press is focusing on a surprise trip by Prime Minister Rishi Sunak to Northern Ireland today. The presumption is that he is trying to win over the DUP nationalist party in support of changes to the Northern Ireland protocol, which could see improved trading relations with the EU. We suspect sterling does not get much of a bounce were a new EU deal announced, with investors quite fatigued on this subject.

Chris Turner

➔ PLN: The FX mortgage saga remains on the table

Yesterday, the European Court of Justice (ECJ) gave its opinion on the FX mortgage issue in Poland. According to the statement, European Union law does not prevent local law from allowing consumers to claim compensation over and above the compensation already common today. On the other hand, banks cannot charge capital costs if the contract with the client is terminated. However, it seems that a clear interpretation of the ECJ's opinion is yet to be found before assessing whether yesterday's statement is negative or not. From the market reaction, it seems that the first direction was negative, however, during the day the Polish market was rather hit by the global story, and in fact, banking stocks in Poland reversed their direction and erased their initial losses.

Of course, this story did not end yesterday, and we will probably see more headlines from local banks and the government in the coming days as to what the expected impact on the banking sector is. As for the market, we are unlikely to see a clear sell-off and a jump-up in the Polish zloty, but the issue remains on the table, and we are more likely to see constant pressure on the zloty to continue to underperform the CEE region. For now, we expect EUR/PLN to stabilise around 4.77.

Also today after the end of trading we will see a rating review of Poland by S&P. We expect the rating to remain unchanged and yesterday's decision should not affect the review. However, the August review assumed a smooth drawdown of EU money, which has emerged as a problem for the Polish government in recent weeks. Moreover, the macro picture is also mixed and after the experience with the recent downgrade in the case of Hungary, the market cannot ignore this review.

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