

FX Daily: If in doubt, seek carry

Major FX pairs look to have settled into early-year ranges and now await the next big input – Thursday's release of December CPI data for the US. The modest back-up in interest rates this year has not damaged the risk environment too much. Investors look to be playing it safe by choosing carry trade strategies in the currencies of Hungary, Mexico and India



➔ USD: Treading water into Thursday's data

FX markets remain generally quiet as we enter a period of consolidation after the dollar sell-off seen late last year. We had started the year thinking that a backup in short-term rates could give the dollar a little support – though in fact, dollar gains have been very modest. Behind that may well be the conviction view that the Federal Reserve will cut rates this year and that, unless something has broken somewhere, increasing long dollar positions would now be a counter-trend trade. On the subject of Fed rate cuts, we now have Fed members more openly talking about (albeit modest) rate cuts this year and yesterday's release of the NY Fed survey saw a welcome decline in inflation expectations on all horizons.

As we have been saying recently, January and February are typically good months for the dollar, and our call is for patience rather than jumping on the next leg of the dollar bar trend just yet. But

the overall environment tends to support more range-bound dollar trading than any aggressive reversal higher in the dollar just yet. On the horizon this week will be the December US CPI data and also a host of US bank earnings released on Friday. We doubt US data will move markets today, but as usual, we will be interested in what the NFIB small business survey has to say about activity, employment, and pricing intentions. It is hard to see DXY trading outside of Friday's 101.90 to 103.10 range today – a range that could well define the entire week.

Looking more broadly at the FX universe we see that in the EM space, the outperformers this year are the Hungarian forint, the Mexican peso, and the Indian rupee. What do they have in common? They are the highest-yielding currencies in their respective trading blocs. With cross-market volatility remaining fairly subdued it is clear that carry trade strategies will have some enduring appeal. The bigger question may be in which currency to fund them.

Chris Turner

➔ EUR: Some better macro news

Our eurozone macro team has not said this for a while, but there does seem to be a path to a slightly less pessimistic view of the eurozone economy. This is based on yesterday's release of [economic sentiment data from the European Commission](#). EUR/USD bulls may now be arguing that the bigger mispricing of the 2024 European Central Bank (ECB) easing cycle (the market prices 150bp of cuts, we see 75bp) compared to the Fed (the market sees 135bp of cuts, we see 150bp) should mean that EUR:USD swap differentials at some stage narrow and send EUR/USD above 1.10. However, over the next month or so seasonal factors may keep EUR/USD in check. We retain a forecast of 1.08 for the first quarter of 2024, and EUR/USD has recently been more led by equities than by rate differentials. We expect EUR/USD to consolidate in a 1.08880 to 1.1020 range near term and await Thursday's CPI data for the next big input to the story.

Elsewhere, EUR/CHF is staying far more offered than we expected. Perhaps we are under-estimating some safe-haven demand related to events in the Middle East or Sunday's election in Taiwan. However, we remain of the view that the Swiss National Bank no longer wants a stronger Swiss franc and that 0.95 is far more likely than a move to 0.90/0.91 from current levels.

Chris Turner

➔ CEE: Polish rates to remain unchanged

Yesterday's numbers in the region showed solid retail sales figures in Romania and [Hungary](#), while industrial production in the Czech Republic disappointed again. Also released were industrial numbers in Hungary. Later, today we will see a decision from the National Bank of Poland. We expect the key rate to remain unchanged in line with surveys and market pricing.

Unless something is unveiled in the statement, today should be a non-event and it will be more interesting tomorrow. As always, Governor Adam Glapinski will hold a conference at 3:00pm local time and hopefully, we will learn more about what to expect from this year. Our economists see limited – if any – room for rate cuts, but the inflation profile will be hit hard by government measures which could change the story here significantly.

FX in the region started the week on the right foot with gains across the board. The CZK reached its strongest levels since the Czech National Bank rate cut in December. After some early morning weakness, we saw the same move in the PLN market and a slightly smaller gain in HUF as well.

However, as we mentioned yesterday conditions for CEE FX are rather deteriorating. Rates are again not keeping pace with core and interest rate differentials are collapsing across the board. Thus, while yesterday's gains are mostly in line with our expectations, it seems to us that they may be fragile, especially in Hungary ahead of Friday's inflation number. In Poland, on the other hand, we think the heavy long positioning built up in recent months will be a problem for new gains.

Frantisek Taborsky

MXN: December CPI should shed light on Banxico easing cycle

As mentioned above, the Mexican peso (MXN) has started the year strongly. This follows its very strong performance last year, delivering 29% in total returns against the dollar in a relatively strong dollar environment. Our investment thesis this year is as follows and as outlined in our [FX Outlook for 2024](#): the peso should receive strong demand all year, but Banxico may be starting to have some concerns over its strength. We say this because the real trade-weighted peso is back at its highs from 2006/2007. We think therefore that, given the opportunity, Banxico could cut rates before the Fed and see the Banxico-Fed policy rate premium narrow from its currently wide 575/600bp.

On the subject of opportunity, today sees the release of December CPI data for Mexico. Any soft figure could shift expectations toward a Banxico first cut in February. Given implied MXN yields through the forwards in excess of 11%, we doubt an earlier easing cycle from Banxico has to hit the peso. However, we do feel it supports non-FX hedged positions in the short-end of the government bond market (MBONOs) and can probably see USD/MXN hanging around the 17.00 area rather than dropping down to last year's low near 16.60.

Chris Turner

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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