FX Daily: Looking for some balance

Dollar losses have abated amid deteriorating risk sentiment, but the ongoing dovish repricing of Fed rate expectations and hawkish rhetoric by the ECB point to upside risks for EUR/USD in the near term. Elsewhere, Hungary's sovereign rating should remain unchanged. Worsening sentiment will be the reason if we see a correction of recent gains in CEE

USD: Taking a breather

G10 volatility has started to wane amid fewer market-moving data releases in the second half of this week and as Asian markets approach the long Chinese New Year holiday. The dollar is stabilising, as the underperformance of stocks seems to be offsetting the recent negative turn in US data.

Yesterday, a surprise drop in jobless claims confirmed that signs of weakness in the US economy are still not being found in the jobs market. The tightness of the labour market remains the key factor precluding front-end bonds from another big rally: markets are still pricing in a 4.90% peak Fed rate and 'only' 60bp of cuts in the second half of the year. Our economics team is calling for a larger-than-expected easing package later this year: 100bp from a 5.0% peak.

For now, however, markets may feel comfortable with the current dollar levels ahead of next week's fresh round of data releases in the US. DXY could hold above 102.00 today, with some focus on housing data and two Federal Reserve speakers (Patrick Harker and Christopher Waller). Discussions over the US debt ceiling are set to be an important driver for markets, but we currently see this having a material impact on the FX market only around the late summer.

Francesco Pesole

EUR: ECB dovish speculation didn't last long

The European Central Bank provided a very reasonable amount of pushback against reports earlier this week that suggested 25bp increases were being considered. Christine Lagarde reiterated her recent hawkish rhetoric yesterday and the minutes from the December meeting all but confirmed the growing pressure from the hawks in the governing council. The details of the 'deal' with the more moderate near term were quite clear: a conservative 50bp hike in December was acceptable only with a pre-commitment to two 50bp hikes in February and March. Taking the ECB guidance at its word has its risks, but those two hikes look very likely at this point.

This is good news for the euro, and as long as US data remains on the soft side, EUR/USD should benefit from a rather supportive rate differential. A test of 1.0900/1.0950 next week looks on the cards, but things may be rather quiet today since the eurozone calendar is quite empty and Christine Lagarde should not surprise with anything new as she speaks again in Davos.

Elsewhere in Europe, Norges Bank held rates unchanged at yesterday's meeting but announced that it is likely to raise them again in March. That should be the last hike of the cycle according to the NB projections, even though the Bank did not go as far as explicitly saying so yesterday. That may have helped offset the negative impact on the krone, which remains driven by external factors for now.

Francesco Pesole

GBP: A negative surprise with one piece of optimism

UK retail sales for December were released this morning and delivered a pretty strong disappointment. Numbers are down roughly 1% month-on-month and follow another dip in consumer confidence in data released earlier this morning. Because of volatility surrounding the Queen's funeral last year, it looks like fourth quarter GDP will be flat. But ongoing weakness in consumption, and some expected declines elsewhere (construction/manufacturing perhaps), mean first quarter GDP will probably fall by upwards of 0.5pp. One piece of good news - it looks like the government won't need to increase household energy bills from April, or if they do the uplift will likely only last one quarter. That should mean the squeeze on consumers isn't quite as bad as first feared.

While the economy is still showing signs that it's headed for recession through 2023, ongoing pressure in wages and core services inflation suggest the Bank of England is on course for one final 50bp rate hike in February, rather than the more modest 25bp move the Fed appears to be heading for. The pound has reacted negatively, down 0.30% after the release. However, we continue to favour GBP versus the dollar but see moderate upside risks in EUR/GBP.

Francesco Pesole

CEE: No change expected to Hungary's rating

Today, we have only labour market data from Poland on the calendar. We expect wage growth to slow at an annual pace but remain above market expectations. At the same time, employment growth should remain solid despite the slowing economy. Later today, Fitch will publish a rating review of Hungary. We expect the rating and outlook to remain unchanged. While we still see downside risk to the outlook, we expect that the current EU story and fiscal policy developments should be sufficient to warrant no change in today's review.

In the FX market, the CEE region remains strongly supported with EUR/USD higher and gas prices testing new lows in recent days. The Czech koruna and Hungarian forint, current stars of the region, touched new lows against the euro and the Romanian leu strengthened to its strongest levels in weeks following a record-breaking government bond auction. The Polish zloty, on the other hand, as the only outperformer within the region, continues to slide higher, weighed down by several risks.

Today, on the other hand, we could see a slight retracement of gains in the region resulting from yesterday's correction in equity markets and the deterioration in sentiment after the new year rally in Europe. We expect the koruna to return to 24.00 EUR/CZK and the forint back to 396 EUR/HUF.

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