

FX Daily: Lower US inflation can ignite real rate discussion

We're expecting core US CPI inflation to be in line with the consensus of 0.3%, but our economists say it could be lower. If so, a declining real policy rate would be increasingly hard to justify should the American economy start to cool. Romania should keep rates unchanged, and PLN is heading for new gains



➔ USD: CPI test in focus

A decent start of the week for bonds and European equities has helped Scandinavian currencies outperform amid a generally quiet start to the week as data calendars in key developed markets were empty yesterday, and some 'wait-and-see' approach ahead of today's US CPI release.

Our economists expect a 0.3% MoM core CPI print today, in line with market expectations. US CPI has been recording faster monthly rises than the PCE (preferred by the Fed as an inflation measure), primarily due to the higher weighting of housing and vehicles in the basket. While rents are decelerating, the structure of the CPI series implies these changes take time to reflect in official data. In YoY terms, CPI inflation should come at 3.7% today, even though our economists highlight a greater chance of a lower number than a surprise on the upside.

The hawkish repricing of Fed rate bets hinges on expectations that inflation has remained relatively sticky in January. Despite the strong NFP and ISM numbers, faster-than-expected disinflation would bring the real rate discussion to the fore. A rising real policy rate would become increasingly hard to justify as growth should soften materially in 2024.

We see the rate-cutting cycle in the US starting in May: markets are currently pricing in June as the start-point, but we reckon the risks of a softer CPI print and weak retail sales to revamp expectations for an earlier cut. The dollar is facing asymmetrical risks skewed to the downside this week, but the magnitude of those risks still looks limited. The strong labour market should still hinder further dovish repricing, and we think the dollar will not capitulate before the second quarter.

Francesco Pesole

➔ EUR: Growth outlook not that relevant for the ECB

EUR/USD was rejected around 1.0800 yesterday, but we like the chances of a moderate uptick in the pair this week in line with our dollar view. One risk to this view is the ZEW survey published in Germany today. Consensus is aligned for a modest rise in the expectations index and a small decline in the current situation index.

The release has a history of moving the market, but there are fewer longer-term implications for ECB rate expectations. Despite a variety of views expressed by different ECB members recently, the focus on inflation (over growth) has emerged fiercely in recent communication. Markets are broadly positioned for a soft patch of economic growth in the eurozone, and especially in Germany, and we don't think the ECB will change its narrative meaningfully should the outlook deteriorate a little.

Francesco Pesole

This morning also brought data from the UK labour market. Wage growth is slightly above market expectations with 5.8% but there is still a marked fall from the summer peak to 8%, reflecting a cooling labour market. But still, the number remains too high for the BoE, and we expect it to remain sticky in the first quarter. EUR/GBP is opening lower today, testing the key 0.850 level this morning.

Frantisek Taborsky

➔ RON: No changes just yet

The National Bank of Romania will most likely [stay on hold again](#) and defer the first rate cut to the second quarter of 2024. Better-than-expected inflation developments at the end of 2023, which naturally pull down the entire profile ahead, are helpful for the Bank and allow slightly more room for officials to emphasise that monetary policy is sufficiently restrictive at the moment. The Bank's new Inflation Report and updated forecasts are likely to show lower price pressures in the short-to-medium term compared to the November projections.

The RON market has offered less and less volatility in recent months and we don't expect much change here. EUR/RON has been in a narrow range of 4.978-4.970 for the last month and the central bank doesn't seem to be in any hurry. Therefore, we don't expect any changes here in the

first half of the year and a move above 5.000 only in the second half.

Frantisek Taborsky

PLN: Full of hope for new gains

Yesterday's trading didn't change the picture much in the CEE region. EUR/PLN broke 4.320, which is usually the easy part of the way down, and it's only now that it starts to get interesting when the harder part comes. EUR/PLN touched 4.300 briefly in December. Otherwise, it's a level last seen before Covid. We repeatedly mention long PLN positioning here, which is and will be a long-term problem for further PLN gains. On the other hand, the short end of the IRS curve is already at levels prior to September's surprise National Bank of Poland rate cut of 75bp. This implies decent support for the currency compared to HUF and CZK. Thus, if the market doesn't fall for the false hope of rate cuts after Thursday's inflation print, we see this week as an opportunity to test 4.300 again.

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