

FX Daily: Mixed Fed minutes leave dollar momentum intact

Hawks and doves might both be satisfied with yesterday's Fed minutes. Stressing conditionality seems inconsistent with March cut expectations, but the openness to a QT exit and concerns about the economy point the other way. Still, FX is driven by large swings in the equity market, and the dollar has retained momentum. Eurozone CPI prints are now in focus



⬇️ USD: Some correction risk today

The risk-off environment and coordinated bond/equity underperformance are paving the way for dollar strength. As discussed in yesterday's FX Daily, overstretched stock valuations looked likely to be tested along with hyperaggressive dovish bets at the start of the year, and good ISM manufacturing figures offset any benign effect on bonds stemming from a larger-than-expected drop in JOLTS job openings.

The FOMC minutes did not have a major market impact, but there are a few important takeaways. First, there is a broad consensus that inflation will decline, but also that the FOMC will keep rates high in case of more persistent price pressures. Markets might have been looking for some

validation that the first cut may come as early as March, but the disinflation conditionality does not endorse a move this early. Still, several members saw risks of a rapid worsening in economic and jobs market conditions, which was likely reflected in the more dovish Dot Plot. The biggest surprise was, however, on a quantitative tightening exit, with the minutes showing that members found it appropriate to start discussing the technical factors to slow the unwinding of the balance sheet.

All in all, the minutes were a mixed bag. The conditionality attached to cutting rates is hawkish in the sense that it puts pressure on markets to unwind the March easing bets, but the risks flagged to the economic outlook and discussion about exiting quantitative tightening are unequivocally dovish. The contained impact on the dollar can be explained by the large swings in bond yields and equities yesterday. The dollar is once again more expensive to sell with 10-year Treasuries again close to 4.0%, and the predominance of equity/global risk sentiment as drivers for FX markets means that the dollar dynamics remain strictly tied to markets reassessment of stock market levels.

With equities futures pointing up today, there is a chance for the dollar to give up a portion of recent gains, but we suspect that expectations for a respectable payrolls print tomorrow will prevent large USD corrections. DXY may find a robust floor around 102.00. Today, the focus will be on ADP payrolls, which could move the market but have no predictive power for the official jobs figures.

Francesco Pesole

EUR: Some help from inflation?

Inflation numbers start to flow for eurozone countries this morning. Germany reports regional figures first as usual before releasing its nationwide CPI numbers at 1300 GMT. France will also publish inflation figures this morning, while eurozone-wide CPI will be released tomorrow. There is a broad consensus for a rebound in headline inflation in the whole of the eurozone in the December print, although markets should primarily focus on core numbers, which are expected to keep inching lower (from 3.6% to 3.4% in the eurozone).

That said, there are some risks that a higher headline print will prompt some repricing of the highly dovish European Central Bank rate expectations. The EUR OIS curve embeds around a 60% chance of a cut in March, and 170bp of total easing by year-end. That exceeds rate cut expectations in both the US and the UK, despite the Federal Reserve and Bank of England starting from significantly higher policy rates.

The ability of the euro to benefit from some unwinding of rate cut bets must be weighed against evidence that the EUR/USD is primarily driven by equity/risk sentiment factors at the moment, and the short-term rate differentials remain heavily unfavourable for the euro. A moderate repricing in ECB rate cut bets would not change that picture: the two-year swap rate gap would still argue for a weaker EUR/USD. If anything, we could see some EUR performance emerging in the crosses in the short run but some improvement in the eurozone economic outlook remains necessary to make any EUR rally sustainable.

Francesco Pesole

➔ GBP: EUR/GBP drop may halt

Sterling is lacking domestic inputs at the moment. A plethora of data releases today (consumer credit, mortgage approvals, money supply and final PMIs) are unlikely to move the market. We'll need to wait for next week for some important data points in the UK, with GDP and industrial production published on 12 January.

We discussed yesterday how we saw room for EUR/GBP to slide back to 0.8600, and therefore welcome the drop in pair. However, eurozone inflation numbers today and tomorrow risk delaying the downtrend. Beyond the short-term, where the pound still looks healthier than the euro, we expect Bank of England rate cuts and an unwinding of ECB dovish expectations to offer support to EUR/GBP on a sustainable basis. The 0.90 mark is not out of reach by end-2024.

Cable has recovered some of the earlier-week losses, but we continue to see downside risks extending to the 1.2500 mark in the short run (due to USD outperformance) before a clear-cut upside trend is formed again.

Francesco Pesole

⬆️ CEE: Bond market opening

The bond market will be in focus today. In the Czech Republic, we will see the state budget result for last year. MinFin has already leaked to the media that the result is likely to be better than planned (CZK295bn). Also today (or tomorrow), MinFin is expected to publish the funding strategy for this year, which should confirm our assumption of a decline in bond issuance of around 25% year-on-year. Both should thus support Czech government bonds (CZGBs). Elsewhere, today we will see the first auctions of the year in Hungary and Romania, and in Poland tomorrow, which should test market demand.

CEE FX notched further gains yesterday despite a stronger US dollar again. PLN, in particular, rebounded and erased most of this week's losses. Rates seem to be taking over as the main driver in the region again, which should support all regional currencies. PLN should benefit the most from this perspective, as we mentioned yesterday, but it is still hard to say whether the correction of the strong long positioning is over. We are leaning towards yes, but still want to see more today. For the same reason, we should see further gains in HUF as well, but here the space is more limited, in our view. The CZK should remain flat today unless good news triggers more significant inflows into the CZGBs.

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