

FX Daily: A more relaxed Fed powers the rally

The dollar has broken to new lows for the year after a relaxed-sounding Fed Chair Powell said there were the first clear signs of disinflation. He also failed to push back too aggressively on lower bond yields. Attention turns to Europe, with rate meetings in the eurozone, the UK, and the Czech Republic. Expect European FX to remain bid and the dollar offered



The dollar broke to new lows for the year after the Fed's press conference

📌 USD: Phlegmatic Powell offers little pushback against the rally

The dollar was relatively unchanged on the release of last night's FOMC statement, but Fed Chair Powell's press conference comments sent it around 1% lower across the board. Listening to the press conference, a few things that stood out to us were:

- for the first time, we can see the disinflation process has started,
- a refusal to push back against the softening in financial conditions in the form of lower bond yields and higher equities,
- a data-dependent approach to what the Fed may do with their dot plots in March (lower the

- expected peak in the tightening cycle?)
- a near Goldilocks scenario where inflation can come down, while unemployment does not have to rise

US rates softened on the press conference, with pricing for the Fed funds rate in December 2023 being cut by 10bp to 4.40%. In fact, one can argue that if US rates are not going to be cut as much as the market expects later this year, it will be because of decent growth, rather than sticky inflation. No wonder equity markets liked the press conference and the dollar softened as investors chased growth stories.

As we mentioned in the [FOMC review](#), lower volatility in the rates space will be feeding into lower FX volatility. The MOVE index, an index of implied volatility across the US Treasury curve has dropped back to levels last seen in March 2022. Assuming no major fireworks from today's ECB/BoE meeting or tomorrow's US jobs report, lower volatility will support the carry trade. Here, we like the Mexican peso where high risk-adjusted carry and, unlike the CEE high yielders, positive real interest rates should keep the peso very much in demand.

Positioning is probably the biggest factor preventing a further dollar decline right now, but the benign macro story does favour DXY continuing to drift lower to the 100 area.

Chris Turner

📈 EUR: Too early for the ECB to soften its hawkish stance

The European Central Bank announces its policy decision at 1415CET today and President Christine Lagarde holds her press conference at 1345CET. A 50bp hike is widely expected as is a hawkish message that will support market pricing of a further 75-100bp of tightening into the summer. Please see our ECB preview [here](#) and also the key factors that will drive FX and rates markets [here](#). Our rates strategists think that Lagarde could push back against 2024 easing expectations and see eurozone rates rise in the five-year part of the curve.

EUR/USD opens in Europe above 1.10 - powered by last night's benign FOMC meeting and press conference. Two-year EUR:USD swap differentials have narrowed into 108bp - the narrowest advantage for dollar rates since late 2021. As we discussed in our [EUR/USD forecast revision article](#), a sharp narrowing in rate differentials stands to become a bigger driver of EUR/USD this year and should carry it to the 1.15 area in the second quarter. For the shorter term - there is not much resistance now until the 1.12 area. But buy-side positioning is the longest in the euro since the summer of 2021 meaning that the rally could prove hard work. The EUR/USD story is positive, however.

Chris Turner

The Danish central bank (DN) is set to follow the ECB with a rate hike today. There has been increasing speculation that the DN will hike by 10bp less than the ECB to widen the EUR-DKK rate gap. EUR/DKK is trading around 7.4400, so it currently has a cushion against the lower bound of the peg band (which is around 7.4360). With inflation running at 8.7% in Denmark, we think there is a higher chance that the DN will prioritise fighting inflation for now and follow the ECB with a 50bp hike, which should keep a cap on EUR/DKK for now. After all, the prospect of another 50bp ECB hike in March means that the DN will likely have another chance to under-deliver relatively soon, should EUR/DKK come under fresh pressure and FX intervention start to appear

unsustainable.

Francesco Pesole

➔ GBP: Again, too soon for the BoE to go soft on inflation

1300CET should see the Bank of England hike the Bank Rate 50bp to 4.00%. Governor Andrew Bailey holds a press conference at 1330CET. Please see [our full BoE preview here](#) - including voting patterns for the nine MPC members. Some market participants see a pattern of the BoE hiking forcefully and having a hawkish statement, but treading more dovishly in the press conference. On balance, we think Governor Bailey will not want to push back against expectations for further hikes to 4.25/4.50% this summer but may push back against the cut starting to be priced for December.

Benign global conditions are supportive for the risk-sensitive sterling and suggest GBP/USD could make a run at the 1.2450/2500 area this week. EUR/GBP has drifted higher again. On balance, we would favour continued outperformance given the greater scope for convergence in eurozone and sterling rates at the shorter end of the curve. EUR/GBP may end the quarter near 0.89, but push up to the 0.90/91 area later in the year.

Chris Turner

➔ CZK: CNB to confirm wait-and-see approach

Today, the Czech National Bank meeting is on the [agenda](#) in the region. We expect rates and the FX commitment to remain unchanged, so the main focus will be on the central bank's new forecast and the governor's press conference. With strong rate cut expectations priced in, the main question for today will be what the CNB's expectations are for January inflation, which will set the inflation path for this year. In general, the new forecast should show a higher inflation trajectory compared to the November version, but at the same time, the koruna is more than 3% stronger compared to CNB expectations.

The Czech koruna has reached its strongest levels in more than a decade in recent weeks and is, in our view, the most overweight currency position held by investors in the region at the moment. We believe the main driver right now is falling gas prices and improving sentiment in Europe rather than local factors. However, the central bank plays an important role in determining the koruna. Thus, any hint of an end to the FX intervention regime would likely lead to a sharp depreciation. Overall, however, we believe that the CNB and the koruna do not have too much to offer at the moment. Although gas prices may push to stronger levels in the short term, we think the koruna is too strong currently and rather expect a return to the 24.00 EUR/CZK level.

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