FX Daily: Mounting evidence against a March Fed cut

Another surprise drop in jobless claims suggests that a rate cut two months from now looks increasingly unrealistic. Markets, however, remain reluctant to completely rule it out. Today, we'll hear from a few Fed speakers before the blackout period starts. We think the dollar can stay broadly supported into the 31 January FOMC

USD: Rate expectations' gap with data widens

The US jobs markets continues to work against dovish Federal Reserve bets. Yesterday, initial jobless claims dipped again, to 187k. Only once since the pandemic have claims been lower. Continuing claims also came lower than consensus, while housing starts surprised on the upside. Markets remain attached to the prospect of a March cut, now priced with around 50-60% probability, but we really struggle to imagine the Fed cutting in two months' time against the current economic backdrop.

Despite December's moderately above-consensus read, US disinflation has been the benign story for markets, so expect some focus on today's University of Michigan inflation figures, which are expected to be unchanged from last month. Existing home sales for December and TIC flows for

November complete the US calendar today. Today is also the last day for any FOMC member to comment on monetary policy before the blackout period, and Austan Goolsbee, Mary Daly and Michael Barr are scheduled to speak.

We think the dollar can consolidate after the recent gains, continuing to draw some benefits from Christopher Waller's remarks earlier this week, that may have led markets to favour defensive positions heading into the FOMC on 31 January. The only key data release in the US before then is the fourth quarter GDP figures next week, and barring major surprises there, there is no compelling bearish story for the next week or so.

Francesco Pesole

EUR: Fairly valued

European Central Bank President Christine Lagarde will participate in another panel today in Davos – although the ECB is in the quiet period now, meaning that comments on policy are unlikely. The slew of comments from Davos offered further indications that the consensus at the ECB remains less dovish than market pricing.

Markets were unmoved from the minutes of the December ECB meeting yesterday, in which members steered away from discussing rate cuts. Today, the eurozone calendar is empty, and we think EUR/USD can consolidate around 1.8500/1.0900 today. Our short-term fair valued model shows the pair fairly valued at current levels.

Elsewhere in Europe, Riksbank FX sales will pick up again as the reported week is the first one of January, although volumes should be lower than early December as the holiday season wasn't fully over yet. We took that into account in our estimates for the Riksbank hedging programme to end in early February. Earlier this week, Riksbank's First Deputy Governor Anna Breman warned of risks of inflation revamps, but dropped the tightening bias by saying that there is probably no need to raise rates further. We expect the krona to struggle to find a sustainable appreciation path this quarter as Riksbank FX sales end and the Bank will hardly be able to push a any hawkish narrative further.

Francesco Pesole

GBP: Very grim retail sales

UK retail sales for December came in sharply below expectations this morning. The headline print showed a 2.4% year-on-year contraction, while the measure that excludes auto fuel dropped by 2.1% YoY.

The release has thrown cold water on the GBP rally after the CPI-induced gilt selloff this week. Indeed, soft retail sales paint a less optimistic picture for the UK economy, but inflation (especially on services) remains the primary focus of the Bank of England. This means that a further repricing lower in BoE rate expectations would require markets to make a conviction call that the December CPI surprise was just a blip.

This line of reasoning matches ours, and we expect some 100bp of BoE cuts this year. Since we also deem ECB rate cut bets as too aggressive, we are bullish on EUR/GBP into year-end. However, we think that the back up in EUR rates will be gradual and markets will be reluctant to let go of high-yielding GBP longs so close to the surprise December CPI print. Accordingly, EUR/GBP may struggle to find sustainable support above 0.8600 for now. The 0.8640 is a where 50, 100 and 200-day moving averages converge, and could be the next big resistance.

Francesco Pesole

CEE: More weakness to come

After a busy few days, Friday should be rather quiet in the CEE region. In the calendar today, we only have December PPI data in Poland, where we expect a further drop from -4.7% to -6.0% YoY. However, the FX market still seems to have something to say. EUR/HUF jumped above 382 yesterday for the first time since the start of the year, and as we discussed earlier, we expect more weakness here looking ahead. Rates and FX divergence from the last two weeks combined with the dovish tone of the NBH and political noise from the European Parliament will keep HUF under pressure, in our view. We see stabilisation somewhere around 384 for no, however long HUF positioning may make the situation more tricky in the coming days. On the other hand, we believe that the situation would only start to get uncomfortable for the NBH above the 390 EUR/HUF levels.

The CZK also came under pressure yesterday for the first time following its CEE region peers this week. The markets priced in more CNB rate cuts again despite cautious comments from central bankers and the interest rate differential ticked down a bit against the CZK's favour. We don't expect more weakness here though, and as we indicated earlier this week, 24.700-800 is the range where we see EUR/CZK for these days.

On the other hand, PLN gained some support yesterday for the first time in a week and bounced back below 4.400 EUR/PLN. The lower house of parliament passed a key budget draft and the President indicated support while ruling out the possibility of early elections. This may calm things down for a while, but there are still more than enough open issues that we believe will cause further escalation of political tensions in Poland. Therefore, we remain negative on PLN for the days ahead, although today we could see some gains on the back of the latest news.

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