FX Daily: Navigating data inconsistency

The dollar is back around Friday's open levels against most G10 currencies as markets face contradicting indications from the jobs market and ISM services index. Expect a quiet start to the week before US CPI data on Thursday. The dollar appears more sensitive to negative news but a fragile risk environment should keep USD broadly supported in the near term

USD: Diverging data leaves dollar without clear direction

US activity figures released on Friday raised more concerns about data inconsistency than any clear direction for markets. Our US economist discusses here the above-consensus December jobs numbers. The US labour market is cooling (for lower-paid and part-time employment in particular) but still too slowly to warrant cuts by the Federal Reserve in the first quarter – especially considering wage growth remains sticky and the unemployment rate low. However, the ISM services report seemed to tell a different story. The employment component dropped dramatically into contraction (from 50.7 to 43.3) and the headline index fell unexpectedly to 50.6, the lowest since May and now close to recession territory (below 50).

US 10-year treasuries are back above 4.0% this morning after a drop in yields on Friday afternoon, and the dollar is also trading close to its Friday open against most currencies. The contradicting data releases on Friday likely put off any repricing on a March rate cut, which currently shows a 60% implied probability. Now, the focus shifts to the December CPI report, which will be published on Thursday after a rather quiet start of the week data-wise in the US. This week will also see Fedspeak resume; Raphael Bostic is due to speak today, and a few others are scheduled in the coming days.

Despite the ISM services drop, lingering tightness in the jobs market may encourage Fed members to keep pushing back against a first quarter rate cut. Core inflation is expected to drop below 4.0% (consensus and ING's call are 3.8%), but the December FOMC minutes showed there was a widespread optimistic view on the disinflation path and that is not supposed to change the picture dramatically. Our call remains for a first rate cut in May, and a gradual unwinding of March rate cut bets.

In FX, we think this means dollar crosses won't be following one-way patterns in the coming weeks. We expect the dollar to take back some of the late-2023 losses as the expected start of the easing cycle is pushed forward, but a market that remains generally more sensitive to negative US data than upside surprises should be reluctant to chase the dollar much higher from these levels. We still see some vulnerability in high-beta currencies as the equity market faces some more headwinds in the near term. As discussed below, the euro also appears in a soft spot, meaning the upside risks for the EUR-heavy DXY index are also non-negligible and may extend beyond the 104 December peak over the course of the first quarter.

Francesco Pesole

EUR: Rally above 1.10 still not looking likely

We still see gains above 1.10 in EUR/USD as hard to sustain. The pair is currently driven by risk sentiment and the equity performance differential, while the correlation with short-term rate differentials waned in the latter part of 2023. This means that a strong case for global stock and in particular European equities outperformance would be needed to bring EUR/USD much higher. Incidentally, we expect a stabilisation/correction in global equity performance as opposed to the November/December action, which should allow a relinking of front-end yield spreads with EUR-USD. If that happens, the euro isn't in a favourable position, because the 2-year swap spread differential remains wide at -125bp, and some unwinding of European Central Bank (ECB) rate expectations would hardly bring the spread back to levels consistent with 1.10+ in EUR/USD.

The eurozone data calendar is quiet this week. This morning, German factory orders disappointed; tomorrow, November German industrial production figures are released. Eurozone-wide economic sentiment, retails sales (today) and unemployment rate (tomorrow) are due, but shouldn't move the market. We'll hear from ECB members though, with François Villeroy, Isabel Schnabel, and Philip Lane among others speaking this week. Expect some pushback against rate cut bets, especially after the rebound in inflation in December, although markets have quite consistently "out-doved" the ECB commentary of late.

We continue to see EUR/USD on unstable ground this quarter, and any positive impact from softer US data/better EZ data may be more short-lived than downside corrections. We target a return to the 1.08 mark over the course of this quarter.

Francesco Pesole

GBP: EUR/GBP can slip further this week

Monday and Tuesday will be quiet in terms of UK domestic drivers, and the highlight of the week is Wednesday's parliament testimony by Bank of England (BoE) Governor Andrew Bailey and Friday's monthly GDP figures for the month of November. Overall, we expect a generally positive impact on sterling, especially in the crosses such as EUR/GBP, as Bailey may keep signalling a more cautious tone compared to the market on rate cuts and growth should bounce back in the November print.

We had called for a return to 0.8600 in EUR/GBP as the year started. Now, there is probably some further downside room as BoE rate expectations appear more flexible to a hawkish repricing than the ECB ones, at least in the near term. That said, these are attractive levels to play a longer-term bullish view on the pair based on a deterioration of UK economic conditions and consequently more aggressive cuts by the BoE than the ECB.

Francesco Pesole

CEE: Heavy start of the year

This week we have a very busy calendar in the CEE region. This morning, retail sales numbers were released in Hungary and Romania. Later, we will see industrial production in the Czech Republic, which continues to decline, and the final state budget for last year in Hungary, which could show us how strong the commitment is for this year. Tomorrow, industrial production in Hungary and the National Bank of Poland decision will be published. Here, we expect rates to be unchanged in line with expectations. On Thursday we will see inflation in the Czech Republic. We expect prices to remain unchanged in December, which translates to a steady 7.3% year-on-year. On Friday, inflation will be released in Romania and Hungary. In the first case, we expect a drop from 6.7% to 6.5%. In Hungary, we forecast a decline from 7.9% to 5.7%. Later, there will be a meeting for the National Bank of Romania. Here we expect rates to remain stable until the second quarter.

Conditions for CEE FX deteriorated noticeably across the board last week, but it still managed to secure gains in most cases. However, rates in the region failed to keep pace with rising core, with the exception of the CZK. In addition, the stronger US dollar is also negative factor here. After the downside surprise in Polish inflation, we thus turn negative on PLN for these days, which could stay above 4.340 EUR/PLN for a bit longer, despite the fact that we remain positive here in the medium-term. We are still positive on HUF, which probably has some room to strengthen. We think Friday's inflation will be the first reality check this year that we can expect more rate cuts from NBH rather than less, which should hinder further gains. Conversely, we are turning positive on the CZK, which should benefit from a correction in the dovish/short positioning in FX and rates built over the past two months, the CNB's cautious approach and the inflation print on the CNB forecast.

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