

FX Daily: Patience is a central banker privilege

A week of mixed US data (hotter inflation, softer retail sales) suggests the Fed will remain patient for longer. The privilege of patience is not shared by most investors, and in FX, popular short-dollar positions have been frenetically revamped. This means that more short-term USD resilience (our base case) may not translate into big USD rallies



➔ USD: Dollar bears hit back

Big chunks of the dollar rally induced by hotter inflation data have been unwound following a batch of soft activity figures yesterday. US retail sales fell more than expected in January, and the control group that excludes volatile items contracted 0.4% month-on-month versus an expected 0.2% increase. This is somewhat concerning: with lower credit availability and sticky inflation dampening purchasing power, spending growth will struggle to recover.

Also yesterday, we observed another below-expectation initial jobless claims print, still signalling the jobs market remains strong, even though continuing claims (people struggling to re-enter the workforce) rose more than consensus. Finally, January industrial production also disappointed, despite some improvement in both the Empire Manufacturing and Philadelphia Fed indices.

Wrapping up a week of data releases, it's hard not to conclude that the Fed likely has interest in keeping a cautious stance for now. Micheal Barr said a couple of days ago that he supports Jerome Powell's "careful approach" to policy normalisation, and that appears to be the consensus among his FOMC colleagues. The view from the Fed, consensus and the market is that inflation will ultimately turn decisively lower, but the jobs market and inflation prints themselves are raising the risks this will happen at a later stage than thought. Indeed, signals from other activity indicators like retail sales have pointed at the opposite direction, but fourth quarter GDP data should still be good, and it will take some time for the whole activity story to materially soften.

So why has the dollar taken the hit? This is not really related to a major change in the Fed view by markets; the first cut is still expected in June, and the whole one-year segment of the Fed Funds future curve has shifted by some 20bp lower in the past week. In our view, the dollar correction is again the symptom of some investors' impatience to join what remains a consensus view, despite recent data, that the USD will decline at some stage in 2024. This is also why we think EUR/USD is not too far from a supporting floor despite more dollar strength in the near term.

Looking at today's events, the US data calendar includes PPI inflation, housing starts, and the University of Michigan sentiment. Expect more USD sensitivity to incoming releases, especially PPI and U. Michigan prints, should they tell a different story than the CPI report. We expect, anyway, some dollar consolidation in the coming days, still with some upside risks.

Francesco Pesole

➔ EUR: Lagarde confirms cautious approach

ECB President Christine Lagarde reiterated the need for caution when discussing monetary easing yesterday. The emphasis one once again put on wage pressures, confirming our view that the ECB will want to be reassured that wage growth is under control before starting to cut. We still think markets are right to price in a first cut in June, but are overestimating the size of total easing, which we expect to be 75bp vs 115bp priced in.

Anyway, the good EUR/USD momentum is a mere reflection of the dollar correction. We feel EUR/USD can stabilise around current levels today, but still faces some downside risks in the short-term, in line with our dollar call. The eurozone calendar only includes a speech by Isabel Schnabel (likely to echo a rate cut pushback) this morning.

Francesco Pesole

➔ GBP: Retail sales posts strong rebound in January

UK retail sales for the month of January came in at 3.4% MoM, above all estimates. This follows some softer than expected GDP numbers yesterday, that meant the British economy entered a recession in the latter part of 2023.

As repeatedly discussed in recent reports, the implications of activity data on the Bank of England's policy outlook are not too deep. The focus remains on inflation (especially on services) and wage growth, and it does not seem likely that the BoE will turn significantly more hawkish only on the basis of softer growth and without having reassurances on the inflation side first.

The pound seems to mirror this narrative, declining only modestly after GDP numbers yesterday and gaining a little bit this morning. Still, we like the chances of a stabilisation first (0.85 may be

the bottom), and a rebound then in EUR/GBP, on the back of monetary policy mispricing in the UK and the eurozone.

Francesco Pesole

📉 CEE: Inflation surprises pushing FX weaker

A busy week in the region is almost over. Today's calendar offers only Czech National Bank minutes from the February meeting, when the central bank cut rates by 50bps to 6.25%. We expect a rather dovish tone mixed with the traditional cautious sentence. At least two members pushed for a larger cut move, which should be reflected in the discussion. However, yesterday's massive downside surprise in inflation likely invalidates today's minutes given the markedly different conditions in the CNB forecast. January inflation fell to 2.3% from 6.9% year-on-year, while the CNB expected 3.0%. Core inflation showed an even bigger surprise. We therefore think the central bank will be heading towards a 75bps rate cut at the next meeting. However, there is still another CPI print and EUR/CZK developments will also be key. The currency pair touched 25.50 yesterday after the inflation release as expected but very quickly returned to 25.40. The CZK is showing surprising resilience despite the massive surprise in inflation. As we mentioned earlier, short positioning must be too heavy by this time and moreover, we think that 25.50 EUR/CZK could be a profit-taking level for many investors. Therefore, we expect EUR/CZK to rather stay at the current levels today at around 25.40 EUR/CZK despite lower market rates.

Inflation also surprised on the downside in Poland from 6.2% to 3.9% YoY. PLN rates have shown significant volatility in recent days, making it difficult to read the situation. However, despite some correction after CPI print rates ended lower and we can expect a bit more today. This is negative news for FX, muting our hopes for a stronger PLN for this week. Rates are pointing to levels around 4.350 at the moment but also 4.360 cannot be ruled out today.

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