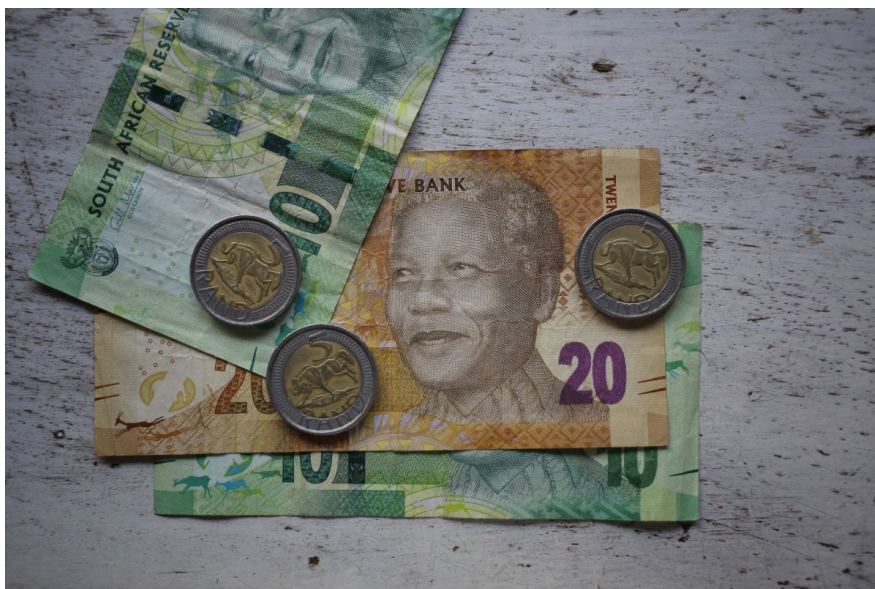


FX Daily: Rand in focus on pre-election budget

Some unfamiliar strength in Chinese equity markets is providing a little strength to non-dollar currencies. And the FX options market hints that investors may not be that pessimistic on EUR/USD after all. It is a quiet day for US data (just FOMC minutes tonight), but we'll hear a few Fed speakers. Also, look out for potential USD/ZAR volatility on the budget



⬇️ USD: Exploring the downside

In quiet markets, the dollar is coming slightly lower. Two factors may well be driving this. The first is that Canada's January CPI came in well below consensus yesterday and triggered a 12bp drop in short-dated yields. Investors may increasingly be thinking that January's US CPI number was an aberration and that when the February CPI figure is released on 12 March, the disinflation narrative will be restored.

The second factor is some unfamiliar strength in Chinese equity markets and the offshore renminbi - the CNH. China's benchmark CSI 300 equity index is now 10% off its recent lows. It may well be a combination of some official ETF buying and some administrative measures that are

driving the rally - questioning its durability - yet USD/CNH has now moved under 7.20 and is dragging USD/Asia lower along with it. As we know, these trends typically provide a soft undercurrent to the dollar.

For today, there is no US data of note, but we have several Fed speakers. And tonight sees the release of the minutes from the 31 January FOMC meeting. Recall this was seen as a pretty neutral meeting until Fed Chair Jerome Powell used an opportunity in the press conference to say that a March rate cut was unlikely. Currently, the market prices around 90bp of Fed easing this year. We suspect the Fed's own forecasts - 75bp of 2024 easing - will be the minimum amount of easing the market will now price. And that is why, as we discuss in this month's [FX talking](#), we think investors and corporates should use dollar strength this month to position for lower levels later in the year.

We have been saying this week that a low volatility environment means that breakouts should not be chased. So let's see whether DXY stays confined to something like a 103.80-104.40 range.

Chris Turner

➔ EUR: FX options market less pessimistic

We have recently been discussing the very low levels of implied and realised volatility in EUR/USD. At the same time, however, the risk reversals - the price of a euro put over a similar delta euro call - have actually been showing the market becoming less pessimistic on the euro. For example, the one-year 25 delta EUR/USD risk reversal has edged up to -0.77% - the narrowest skew to euro puts since last summer. The same is seen in the 3-month risk reversal at -0.29%. Despite the doom and gloom surrounding the eurozone economy, it seems that investor conviction over a lower EUR/USD is fading.

Back to the short term and today sees eurozone consumer confidence for February. A mild improvement is seen here. And if there is a ray of light for the eurozone economy it may be that [wage growth](#) is not falling as quickly as inflation and that there may be a boost from rising real incomes after all.

On the day, perhaps we should not get too excited by a little euro strength and perhaps the default view should be that EUR/USD stays slightly bid in a 1.0780-1.0840 range.

Chris Turner

➔ GBP: £23bn is the number

The Resolution Foundation has today [released a report](#) suggesting that UK Chancellor Jeremy Hunt has £23bn of fiscal headroom for stimulus at the 6 March budget. That prospect of fiscal stimulus may be one of the reasons that sterling is not falling harder after Bank of England Governor Andrew Bailey yesterday said that the BoE does not have to wait for inflation to hit 2% until it cuts rates. Bailey's comments did trigger a decent rally at the short end of the UK gilt curve, however.

The 6 March UK budget could also throw up some wild cards on incentives of UK pension funds to invest in UK asset markets. The decline of London's ability to attract major listings has been well-documented and some incentives here - including the additional concept of a British Individual Saving Account - could prove something of a wild card to sterling's prospects.

A softer dollar environment could see GBP/USD edge up to 1.2670/80 today, but we would not chase the move higher.

Chris Turner

📌 ZAR: USD/ZAR has been quiet, too quiet

For a highly volatile FX pair, USD/ZAR has been exceptionally quiet. Today presents a sizable event risk in the form of the South African annual budget. This will be a pre-election budget since general elections will be held in late May.

The challenge for South Africa's Finance Minister Enoch Godongwana will be seeking out pre-election giveaways while continuing to show that South Africa's debt-to-GDP trajectory will be stabilising at around 78% in 2025/26. That will be a challenging task given weak growth. And perhaps the biggest focus for FX markets will be whether the government decides to tap into the South African Reserve Bank's contingency fund for government spending plans. That would be a very bad look and probably trigger a strong upside break-out in USD/ZAR.

A USD/ZAR close above its 20-day Bollinger Band at 19.14 today (Bollinger bands are used as a tool in technical analysis to pinpoint breakouts from low volatility regimes) suggests the rand could be running into a lot of trouble over the next month.

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