

## FX Daily: Short end continues to drive the dollar

The dollar is holding onto recent gains. The continuation of better US activity data this quarter provides leeway for the Fed to remain hawkish and is keeping short-dated US yields firm. It is hard to see this changing in the short term. The data calendar is quiet today, but we have several Fed and ECB speakers. Look out for more on Polish FX mortgage news today



### ➔ USD: A delicate balance

Another day and another piece of positive US activity data. Yesterday saw a strong [January retail sales release](#). Though boosted by warmer weather, the data still positively contributes to the first quarter activity story where the Atlanta Fed's GDPNow measure for the first quarter has been revised up to 2.4% from 2.2%. 'Wot recession?' some might ask. The data provides ammunition for the Fed to remain in hawkish mode and for the market to continue to price two to three more 25bp Fed rate hikes by the summer.

February's hawkish re-assessment of Fed policy has lifted short-dated US yields by 50bp over the last two weeks and reinserted a little volatility back into the interest rate and FX space. The 2-10 year US Treasury curve remains as inverted as at any point in this cycle - providing the dollar with support. Arguably the dollar could/should have traded even stronger given the backup in US rates.

The reason it has not traded stronger is probably down to the risk environment. Equity markets are holding onto early-year gains and recent buy-side investor surveys show that cash levels - though dipping - are still far from levels to suggest the buy-side is fully invested in this equity rally. Indeed, surveys still point to underweight positioning in equity markets.

We suspect this delicate balance between a hawkish Fed and a buy-side still looking to add to risk assets will leave the dollar range-bound for the rest of this quarter. 1.05-1.10 could be the broad range in EUR/USD and something like 128-136 for USD/JPY - the latter also having to deal with a new Bank of Japan governor.

For today, the US focus will be on the January PPI numbers (core expected to decelerate to 4.0 from 4.6% year-on-year), initial claims and the Philly Fed business outlook. We will also hear from the Fed hawks Loretta Mester (1445 CET) and James Bullard (1830). DXY should trade within a narrow 103.50-104.00 range.

*Chris Turner*

## ➔ EUR: 1.08 remains our 1Q forecast

It looks like EUR/USD is settling into a broad 1.05-1.10 trading range this quarter - leaving us comfortable with the EUR/USD profile we outlined in our latest FX talking publication: '[Soft landing, hard landing, no landing?](#)'. That profile saw EUR/USD ending the first quarter near 1.08 before pushing decisively above 1.10 in the second as the US disinflation story accelerated at a time when China was reopening. The European Central Bank hiking a further 75bp - taking the deposit rate to 3.25% in May - certainly helps too, although the recent repricing in the Federal Reserve cycle is somewhat muting this story.

There is not much in the way of eurozone data today and perhaps the most interesting ECB speaker will be Chief Economist, Philip Lane. A 1600CET he delivers the Dow Lecture at the NIESR in London - the lecture entitled: '[The Euro Area Hiking Cycle: An Interim Assessment](#)'. Presumably, he will not want to push back too much against the 115bp of tightening priced by the markets this summer - even though we think it will be closer to 75bp.

EUR/USD is bouncing off the recent 1.0650/0660 lows helped by a slightly positive risk environment coming out of Asia. We would expect it to continue trading well within the confines of a 1.0650-1.0750 range today.

*Chris Turner*

## ➔ GBP: Gains proving hard work

Sterling continues to show high sensitivity to monetary policy. This week's slightly [softer-than-expected wage](#) and [core CPI data](#) have seen sterling hand back a budding rally. We suspect this will be the story for most of this year, where we see EUR/GBP trading in the 0.89/90 area. GBP/USD may, however, get a lift in the second quarter if we are right with our dollar call.

The UK data calendar is quieter today ahead of tomorrow's release of January retail sales. Bank of England Chief Economist, Huw Pill, speaks at 1800CET, where he delivers a fireside chat on monetary policy. He's been seen as a little more hawkish recently and may choose to maintain that position until the BoE has finished its tightening cycle. We look for one last 25bp hike at the 23 March meeting - taking Bank Rate to 4.25% - where it will be left until summer 2024.

For today, cable should continue to find support in the 1.1950/2000 area.

*Chris Turner*

## 📌 PLN: FX mortgage saga strikes back

Today is a big moment for the Polish banking sector. This morning we should hear the decision of the European Court of Justice (ECJ) in the FX mortgage case. As we mentioned earlier, this dispute is probably one of the main reasons why the zloty has significantly underperformed the CEE region this year. Thus, today's result should show whether the market's fears were real. And what is actually on the table? The ECJ was asked by a local court whether or not banks should receive interest on mortgage capital even when the loan contract had been invalidated by the court due to abusive clauses. Domestic courts are still struggling to judge how mutual obligations should be resolved if the loan is ruled to be invalid.

In the event of a negative ruling for the banking sector, this would mean additional losses for the banks, which would of course have negative implications for Polish assets. It is hard to say what to expect today and how clear the decision will be. Another uncertainty is how much this risk is priced in. However, in any case it is an important tail risk for the zloty and Polish government bonds. Our Warsaw team covered all the details of the FX mortgage case [in a recent article](#). It will be tough for the zloty to navigate through this news flow but as we mentioned earlier, we retain a bearish bias and expect the zloty to test 4.80 EUR/PLN.

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