

FX Daily: Soft landings playbook

The soft landing playbook could see a temporary reversal today were the December US jobs report to come in on the strong side. The market seems to have gotten a little ahead of itself in pricing the speed and magnitude of 2024 rate cuts. A further backup in short-term rates should be mildly dollar positive and risk negative, although this should be a correction



USD: Modest back up in short term rates can support dollar

The start of 2024 FX trading has been characterised by a modest reversal of some of the very benign, pro-risk trends that dominated late last year. At the heart of the story is the consensus view of a US soft landing, where inflation back on target can allow the Federal Reserve to bring rates back to some kind of normal level (e.g. to 3% from 5.25% today) without the economy needing to contract sharply. At its peak in late December, this story had the market pricing around 160bp of Fed easing in 2024, with the first cut priced as early as March. The start of the year has poured a little cold water on that kind of optimism, and our team retains a view that the first cut will come in May. With money markets currently pricing 16bp of easing in March this year, there is still clearly some room for a further back-up in short-term rates.

What this all means for FX is that those high beta, pro-cyclical currencies that performed the best during last year's rally can continue to hand back some gains. Notably, since the correction higher in short-term US rates since the end of December, the G10 FX under-performers have been the high-beta Scandinavian currencies and the commodity currencies. The out-performers have been

the defensive Swiss franc and Japanese yen. In aggregate, the heavily European-weighted DXY has bounced around 1.5% off the late December lows. We think this trend has a little further to run.

On the day, we see decent resistance for DXY in the 102.65/75 area above which DXY could push to 103.20 on a strong US jobs report. However, we have a conviction call that the dollar will be lower later this year and we would assume that anywhere above 104 in DXY will meet some good medium-term selling interest. Also one of our preferred trade ideas, short EUR/AUD, could hand back some further profits today if the commodity complex is hit – but sticky eurozone inflation and re-pricing of the European Central Bank (ECB) easing cycle deliver some euro out-performance.

Chris Turner

➔ EUR: Sticky eurozone inflation can help the euro

Yesterday's firmer-than-expected [German inflation](#) (albeit on base effects) triggered a 10bp rise in short-dated EUR swap rates and offered the euro some support in an otherwise slightly negative environment. Today's release of December CPI for the euro area looks as good an excuse as any for a re-pricing of the 2024 ECB easing cycle. This year has already seen 20bp priced out of the 2024 ECB easing cycle, but similar to the Fed, we think the market prices in too much ECB easing too soon. For example, the market has 34 bp of cuts priced for the April meeting, whereas our team does not see the ECB starting its easing cycle until June.

Re-pricing of the ECB easing cycle should offer the euro a little support. Working against the euro, however, will be the investment environment. If we are right about the need for short-term rates to rise a little further, presumably equity markets hand back a little more of their late-year gains. Given that the investment environment has been the key driver of EUR/USD over the last couple of months according to our short-term models, it looks like EUR/USD will struggle to rally even if ECB easing expectations are unwound. We suspect that EUR/USD can trade in some kind of 1.0880-1.0970 range on the day. Recall as well that January and February are typically good months for the dollar, meaning that positioning for a 2024 EUR/USD rally requires patience and that opportunities at or below 1.08 will probably be seen this quarter.

Chris Turner

➔ GBP: Performing quite well

Sterling has been performing quite well. Notable to us is that late last year the pricing of the Bank of England (BoE) easing cycle played catch-up with that of the Fed, yet sterling did not register any stand-out under-performance. In the past, sterling has had a decent correlation with the equity environment – which may explain how sterling survived the lower rate environment.

We are bullish on EUR/GBP this year, with an end of the first quarter target of 0.88. The wild card delivering sterling out-performance could be the UK fiscal story as the Conservative government promises further tax cuts before a likely election in the second half. For the time being, however, we do think 0.8600 proves the lower end of the trading range and think some re-pricing of the ECB easing cycle can bring us back to 0.8700 in the short term.

Chris Turner

➔ CEE: Polish inflation and CNB minutes show further direction

Today, we have the busiest calendar out of this week in Central and Eastern Europe. Firstly, we'll see the final GDP numbers in the Czech Republic, which could show us some interesting details from the economy and will be an important area for the Czech National Bank (CNB) to consider in its next steps with rate cuts. The central bank will also release minutes from its last meeting today when it started the cutting cycle with a 25bp cut to 6.75%. Here, we'll hopefully get some details from the decision-making process that could reveal the way forward. For now, we expect another 25bp cut in February and 50bp in March.

Later in Poland, December inflation will be released. We expect a slight increase from 6.5% to 6.7% year-on-year, slightly above market expectations. On the other hand, core inflation should drop from 7.3% to 7.0%. The question here is the development of food prices, which are likely to have risen significantly in the rest of the region. Thus, the Polish number could give us clarity for the numbers for the rest of the region released next week. For the FX market, we maintain our preferences from the previous days – positive on HUF and PLN, and neutral on CZK.

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