FX Daily: Sticky US inflation and the big BoJ dilemma

The dollar has found a bit of support into today's US CPI data, which we expect to show a still too-hot 0.3% MoM core rate for February. The dollar can build on the release for some further stabilisation. Meanwhile, BoJ headlines continue to move the yen. A March hike is under consideration, and Friday's wage data will be the decisive input

US: Core CPI at 0.3% can help the dollar

The dollar enters CPI day in a slightly better shape than last week, having reversed a small portion of last week's losses versus pro-cyclical currencies like GBP, NOK and the antipodeans. That was due to some cooling-off in risk sentiment ahead of the pivotal February inflation numbers released today, which are expected to show a flattening in headline inflation at 3.1% year-on-year and, most importantly, a deceleration in the core rate from 0.4% to 0.3% month-on-month and from 3.9% to 3.7% YoY.

Our economists agree that we'll see a consensus 0.3% MoM core print, largely driven by housing dynamics as well as insurance and medical cost hikes. This remains at least 0.1% above the pace that would provide the Fed with confidence in a return to the 2% YoY target and suggests any rate cut before the June meeting remains unlikely. Expect large downside volatility for the dollar if we see a 0.2% MoM core print. Unlike US jobs data, that would endorse the optimism on disinflation showed by Fed Chair Jerome Powell last week and push markets to add 5bp to fully price in a June cut as well as add bets of a move in May.

If we are right with our 0.3% call, we may not see a big market impact already today, but it could definitely set the tone for a more defensive stance on FX – i.e., a gradual rotation back to the dollar – ahead of next week's FOMC meeting. Before CPI, the NFIB Small Business Optimism index is released and is expected to show a modest improvement.

We were expecting this to be the week for a stabilisation or moderate recovery in the dollar, and we continue to see an upward-tilted balance of risks for the USD in the coming days, with a possibility for a return to the 103/103.5 area in DXY.

Francesco Pesole

EUR: MRR discussion leans on the dovish side

Media reports yesterday suggested that the European Central Bank is leaning towards keeping the Minimum Reserve Requirements at 1%, defying expectations that they would be hiked to 2% at tomorrow's announcement. The move had been championed by the hawkish front of the Bank, and while not having clear short-term implications for the FX market, the decision to keep MRR unchanged may have repercussions on the dove-hawk balance in monetary policy decisions. Anyway, the ECB should leave the option open for tightening the requirement in the future.

In terms of data, we'll see the final release of Germany's February inflation figures, which had come in at 2.5% in the flash estimate. There are no scheduled ECB speakers today, and EUR/USD should be moved entirely by the USD reaction to US CPI figures. The common currency has held up well since the start of the week despite the dollar recovering some ground in G10, but we still see a return below 1.0900 as more likely than a rally to 1.10+.

Francesco Pesole

GBP: Slightly dovish wage data

This morning's UK jobs reports was marginally dovish for the Bank of England. Private sector wage growth is what policymakers will focus on, and it fell from 6.2% to 6.0%. Since this is published as a moving average, a big base effect should add pressure in the next couple of months and push it below 6.0%, according to our economist.

Today's numbers are consistent with the 5.7% first-quarter BoE forecasts, although we believe policymakers will want to wait for April/May CPI data before starting to ease policy, particularly given the big upside surprises in the same period last year. Our call remains for a first BoE rate cut in August.

The pound is trading on the soft side after this morning's data, with EUR/GBP once again failing to find much support at the low 0.85's. Today, the focus will be on speeches by Bank of England Governor Andrew Bailey and hawkish member Catherine Mann.

Francesco Pesole

JPY: Big headlines moving the yen

Volatility on the yen has remained elevated since the start of the week, with a couple of headlines impacting Japanese markets this morning. First, Bank of Japan Governor Kazuo Ueda delivered some comments on the economy, which were closely scanned by the market and sent the yen lower this morning. Ueda stated, "although there's weakness in some household spending data, my view is that the gradual recovery continues". Sluggish private consumption (-0.3% quarter-on-quarter) was a stain in the otherwise decent fourth quarter GDP report, which saw Japan narrowly avoiding a recession. Ueda also mentioned the relevance of data coming "this week", which seems to point to Friday's wage talk results.

The yen also received some positive news this morning, which halted the rebound in USD/JPY. Media outlets are reporting that the BoJ are undecided on whether to hike rates in March or April and that the wage information on Friday essentially holds the keys to the decision. It is also reported that the decision should be close, and it may be up to Ueda to reach a consensus on his view. Should rates be kept unchanged next week, officials are reportedly planning to signal that a hike is on the cards to temper the market impact.

As discussed here by our Japan economist, Rengo, the Japanese Trade Union Confederation reported that its member unions demanded an average wage hike of 5.85% at this year's Spring Wage Negotiations, an increase from last year's 4.5% demand and the highest in 30 years. While a lower rate is likely to be agreed, this year's wage growth may end up being close to 4-4.5%, well above last year's 3.6%. That would be consistent with an imminent end of the negative interest rate policy by the BoJ, although our base case is that this will only happen in April. We expect only a change in forward guidance next week.

The JPY curve currently shows a 73% implied probability of a hike next week, although by the end of the week we may see it being scaled back as much as being pushed to fuling pricing in a move depending on Friday's wage data. For today, USD/JPY will be impacted by US CPI data and may find some support.

Francesco Pesole

Authors

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Disclaimer