

FX Daily: Stress testing the consensus view

The week ahead sees several key event risks for FX markets - largely in the form of central bank meetings in the US, eurozone, and other parts of Europe. Fresh communication from central bankers will stress test investors' view that the peak in tightening cycles is close at hand. A Fed push-back against 2H23 easing expectations could support the dollar



➔ USD: Action kicks off tomorrow

The dollar starts the week in very narrow ranges and not far from the lows of the year. This week will stress test the consensus view amongst investors that i) the Federal Reserve will start to acknowledge easing price pressures and soon end its tightening cycle, ii) China reopening will support global growth and iii) that lower energy prices mean improved European growth prospects.

Our macroeconomists discuss many of those themes in their [week ahead preview](#), including links to full previews for this week's FOMC, European Central Bank and Bank of England meetings. Our FX contribution to the FOMC preview outlines a scenario where the dollar could sell off and EUR/USD

trade over 1.10 were the Fed to hugely surprise by suggesting that any additional hikes, after this week's 25bp increase, would be data dependent. That seems unlikely. More likely is the Fed pushing back against the 50bp of easing priced into the second half of the year and the dollar enjoying a brief rally.

In addition to Wednesday's FOMC meeting, the US data calendar contains two important pieces of US data. The first is Tuesday's release of the fourth quarter Employment Cost Indicator (ECI) - one of the Fed's preferred gauges of price pressures in labour markets. This had spiked to 1.4% in the first quarter of last year from the previous three months, but is expected to drop back to 1.1% in the fourth quarter from 1.2% in the third. Any upside surprise here could see expectations swing toward a more hawkish FOMC outcome. And Friday sees the US January jobs report. ING's US economist, James Knightley, sees the headline job creation starting to dip. And assuming there are no upside surprises in the average earnings figures, we assume this data release would continue to support the benign, dollar-bearish environment.

Clearly, it is a busy week for FX with arguably most of the volatility coming between the FOMC meeting outcome on Wednesday evening and the ECB/BoE decisions and press conferences on Thursday lunchtime. In the background, this week also sees the reopening of Chinese markets after the Lunar New Year public holiday. Investors are very bullish on China reopening prospects and will need to be fed more supportive data points this week. Here, tomorrow sees the Chinese PMIs for January, where sizable rebounds are expected - and required to support bullish positioning.

Our game plan sees the dollar staying supported into Wednesday's FOMC meeting (e.g. DXY holding support down here at 101.30/50), but any FOMC-inspired rally in DXY to the 102.50/103.00 area proving temporary.

Chris Turner

➔ EUR: Drifting into Wednesday/Thursday

As above, Wednesday/Thursday could prove the most volatile period of the week. Our core view for the ECB meeting is that the central bank will stay hawkish and push back against the easing priced in for 2024. That should see two-year EUR:USD swap differentials continue to narrow and be positive for EUR/USD. We had cited this narrowing in swap differentials as a major factor when [revising our EUR/USD forecasts substantially higher](#).

Before Thursday's ECB meeting, today sees the release of January economic confidence readings for the eurozone. These are expected to have improved marginally, but any upside surprises would feed the narrative of lower energy and strong fiscal stimulus ensuring that recessions if seen, are mild.

Expect EUR/USD to drift in a 1.08-1.09 range - probably into the US ECI data release tomorrow.

Chris Turner

➔ GBP: Bank of England could be supportive

As we discuss in the [BoE monetary policy preview](#), a 50bp rate hike could prove mildly supportive for sterling. Our base case of a 50bp hike is not fully priced by the market. And with wage pressures remaining firm and base effects not expected to see CPI rolling substantially lower until

the second quarter, it looks too early for the BoE to be sounding the all-clear on inflation. Depending on the state of the dollar after the FOMC meeting, GBP/USD could be pressing 1.2500 by the end of the week.

Chris Turner

➔ CEE: Czech National Bank to confirm stable rates

After a busy two weeks in Poland and Hungary, the [main focus](#) will shift to the Czech Republic. But first, today, we will see the final GDP number for Poland for last year. On Tuesday, fourth quarter GDP for the Czech Republic will be released. On Wednesday, we'll see the Czech Republic's state budget for January and PMI numbers across the region. We expect sentiment to improve in Poland, to be unchanged in the Czech Republic, and to deteriorate in Hungary.

The Czech National Bank is scheduled to hold its first meeting of the year on Thursday. We expect rates and the FX commitment to remain unchanged. The main focus will be on the central bank's new forecast and outlook for January inflation. Thus, given the risk of higher inflation in the first quarter, we expect the tone to remain unchanged with the Bank citing "higher rates for longer" and warning that it does not "rule out a rate hike at subsequent meetings". However, we expect that rates will remain stable at least until the second quarter.

In Hungary, S&P on Friday decided to downgrade the rating by one notch to BBB- with a stable outlook, highlighting the impact on the economy due to Covid-19, the Ukrainian war, and delays in EU money flows.

The FX market in the region this week will, of course, be driven mainly by the global story and high volatility will not be a surprise. However, overall global conditions should remain positive for the region. Moreover, gas prices are testing new lows again, which is always good news for CEE. On the local front, we expect the Hungarian forint to absorb the negative shock of the downgrade and move back towards 395 EUR/HUF. In our view, the Czech koruna has the heaviest long positioning at the moment and therefore we see no room for the CNB meeting to support a move lower. On the contrary, we believe the koruna is overvalued and should move back towards 24.0 EUR/CZK.

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