

FX Daily: The big EUR re-rating

Lagarde's hawkish turn yesterday lifted European currencies and exacerbated USD weakness: [we now expect](#) EUR/USD to trade in the 1.13-1.15 range into the March ECB meeting. The USD underperformance after the latest US payroll releases and risks of a negative read today mean that a rebound in USD may have to wait for next week. The same should be true for CAD.



⬇️ USD: More downside risks from today's payrolls

The hawkish tone set by the Bank of England and the ECB yesterday reverberated across the FX yesterday, ultimately exacerbating the dollar downtrend and pushing DXY back below 95.50. A major slump in US equities driven by yet another drop in US tech stocks seemed to go unnoticed in the FX market amid major central bank announcements, as pro-cyclical currencies held on to gains until the Asian session triggered some catch-up overnight. The three safe-havens - USD, JPY and CHF - all remained offered. Other European currencies like NOK and SEK rallied after the hawkish ECB message, despite their high correlation with equity movements. SEK, in particular, seemed immune to the US tech stocks slump, despite having a high sensitivity to that specific segment.

US and European stock market futures suggest risk assets could take a breather today, as all focus will be on the US jobs report for the month of January. ADP payrolls numbers fell into negative

territory earlier this week, which has led consensus expectations to a rather unexciting +40k read. This suggests that a USD-negative reaction may only be triggered by a headline number below zero. We note how the dollar has had a tendency to underperform after NFP releases, having fallen after 8 of the last 10 NFP releases.

While yesterday's hawkish signals from the ECB warrant some adjustment in the EUR/USD outlook for 2022 (we discuss this in the section below), our view that the dollar will stay supported in the first stages of the Fed tightening cycle has not changed. After all, the pricing on Fed tightening (five hikes in 2022) appears to be one of the few among G10 central banks that is not overly hawkish, and we doubt that one grim jobs report will be enough to derail the plans of the inflation-focused FOMC.

In the near term, a balanced positioning after the recent moves should put markets more at ease with rebuilding Fed-backed dollar longs, although that will likely have to wait until the market has digested a probably not-so-good jobs report today. The ability of DXY to hold above 95.00 would be a welcome development in this sense.

📈 EUR: Looking at new ranges after the ECB's hawkish shift

Eventually, the ECB budged. An unchanged monetary policy statement yesterday was followed by a press conference that instead took a quite hawkish turn. While President Lagarde's comments stressing the upside risks to inflation were not all that surprising considering the latest CPI reads in the eurozone, it was likely the ambiguity around the timing of the first hike (forward guidance for 2023 was implicitly dropped) that triggered the aggressively hawkish market reaction that ultimately led to another big leg higher in EUR/USD.

[Our economics team now sees](#) a material risk that the ECB will accelerate the unwinding of purchases under the APP and start hiking rates already in 4Q22. We think this warrants a change in our projected profile for EUR/USD. We discuss this in detail in "[EUR/USD: A new range after the ECB meeting](#)", where we conclude that it is indeed possible that the Fed-ECB divergence peaked last week after the FOMC meeting. Accordingly, last week's 1.1130 lows might have been the cycle lows for EUR/USD.

We think a market that is building up expectations around an imminent shift in the ECB stance can provide a quite solid floor to the EUR in the run-in to the pivotal 10 March meeting. We expect EUR/USD to trade within the 1.13-1.15 range in this period.

Still, the market pricing on ECB tightening (a 10bp hike in June, 50bp by year end) appears too aggressive, which means that the upside room for EUR/USD in the medium-term still appears capped. We favour a flattish profile around 1.12-1.13 for the remainder of the year.

➡ GBP: Hawkish BoE set to give more support

The Bank of England hiked interest rates by 25bp yesterday, starting the reduction of its balance sheet, in line with expectations. More crucially, four out of nine MPC members voted for a 50bp increase, which sent a strong signal of endorsement to the market's pricing for five more rate hikes this year.

As discussed by our economist in the [BoE meeting review](#), we now expect rates to be raised again in March and May. While market pricing on tightening appears a bit too hawkish, this may not be

challenged until later in the year, which should leave the pound able to withstand any appreciating pressures in the dollar and the euro. As repeatedly stressed in recent publications, we see no evident downside risks for the pound from a potential departure of Prime Minister Boris Johnson.

A continuation of the soft dollar environment today could see Cable test the 1.3750 January highs, while EUR/GBP could stabilise around 0.8400 now after a short-lived move yesterday to the 0.8300 mark.

📌 CAD: A similar fate to USD?

The Canadian dollar has mostly been a bystander in the latest market developments. We think that behind the inability of the loonie to cash in on the soft USD momentum is some negative spillover effect from some re-rating of the US growth story, to which CAD is historically highly sensitive.

Jobs numbers in Canada look unlikely to turn the tide for the loonie today, as the tough Covid restrictions in parts of the country in January likely led to a drop in employment. Some silver linings could only emerge if the job losses have mostly been mostly among part-time workers, and if wage growth has remained somewhat resilient.

While likely to keep CAD weak in the crosses, it must be acknowledged that the Bank of Canada was likely aware of the lockdown-induced slack in January when it signalled it would start hiking in March, and we doubt that today's numbers will dent the prospect of six rate hikes by the end of 2022, which is currently what markets are pricing in.

USD/CAD should remain within the 1.26-1.27 range in the near run, but we expect the BoC tightening to offer some tailwind to CAD in the remainder of the year and we target sub-1.25 levels already in 2Q.

Author

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

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