

FX Daily: The ISM litmus test

After grim December numbers and encouraging January ones, today's ISM services index will tell us which of the last two reads was the aberration in the series. All seems to point to December being a one-off drop, and levels above 54 will be enough to endorse the Fed's hawkish tone and support USD. At the ECB, a 4.0% peak rate is now seemingly on the table



Join our economists and strategists for a live discussion on the upcoming US Federal Reserve, European Central Bank and Bank of England meetings. We'll run through our expectations and what the meetings could mean for financial markets.

9 March 2023, 15:00-15:40 CET, via Microsoft Teams.

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➔ USD: Consensus expects a stabilisation in ISM services

Volatility, rather than trend, has been the name of the game in G10 FX this week. The dollar

continues to draw benefits from the hawkish Fed narrative and good US data, but strong Chinese PMIs on Wednesday worked as a reminder that China can do the heavy lifting to restore global risk appetite.

Today, all eyes will be on the US ISM service index for the month of February. Remember that a surprise drop to 49.2 (i.e. recessionary territory) in the December read was the trigger for a dovish repricing in Fed rate expectations and a weakening in the dollar. The sharp rebound to 55.2 in the January read (pretty much the same level as November) posed a serious counterargument to recession speculation and paired with strong jobs data to send expected Fed rates and the dollar higher. So, the February figures released today will essentially tell us whether the aberration in the ISM Service series was in December or January. Given the very strong correlation between levels below 50 in the index and a US recession, the impact on markets can be sizeable.

Consensus is centred around a marginal decrease from 55.2 to 54.5, which would confirm speculation on recession is too premature and would continue to endorse the Fed's hawkish rhetoric. We think this should allow further stabilisation of the dollar around current levels. A return to sub-50 levels is seen as rather unlikely and would cause a significant unwinding of hawkish Fed bets and probably the start of a new dollar downtrend. A read in the 50-53 area would probably be enough to generate some dovish repricing and should weigh on the dollar. However, as long as jobs data remain strong (payrolls are released next week), we shouldn't see a dollar downtrend fully materialise.

We'll hear from some Fed speakers today (Lorie Logan and Michelle Bowman) after the ISM release, in the build-up to next week's Senate and House parliamentary hearings by Fed Chair Jay Powell. Barring huge surprises on today's ISM figures, we should continue to hear a hawkish data-dependent narrative, which should keep capping high-beta FX and supporting DXY above 104.00.

Francesco Pesole

➔ EUR: 4% narrative shielding against USD strength

The good news for the euro in this environment of consolidating dollar outperformance is that the hawkish repricing in the eurozone is also breaking new highs. After some reasonably hawkish [ECB minutes](#), the ECB's Pierre Wunsch explicitly put the 4.0% peak rate idea on the table – something markets had been flirting with for a few days. The OIS curve now fully prices in a 4.0% depo rate by October, and no rate cuts until well into 2024.

This is 50bp above our economics team rate expectations, and probably looks too premature to even discuss such a large commitment now, but the interest in sounding as hawkish as reasonably possible at this stage is very clear: the latest inflation data pointed at building core price pressures and the ECB desperately needs to keep eurozone rates well supported. The fact that this is also preventing another large decline in the euro is also a welcome effect for the ECB: the two-year EUR-USD swap rate differential has started to narrow again, currently at -133bp after touching -150bp last week.

Let's see whether this 4.0% narrative gains more momentum among other ECB speakers today. Wunsch will speak again, along with Robert Holtzmann, Luis de Guindos, Bostjan Vasle and Madis Muller. The eurozone calendar includes final PMI reads for February and PPI numbers for January, but the US ISM services numbers are likely to be the only true data release to watch for EUR/USD today. Rangebound volatility in the 1.0550-1.0650 area may be the norm into next week.

Francesco Pesole

⬇️ GBP: BoE cannot match ECB hawks

EUR/GBP has stabilised after Wednesday's big rally. The ECB's narrative has fallen more convincingly on the hawkish side compared to the BoE's, and yesterday's Decision Makers Panel survey signalled that firms now expect to raise prices and wages at a slower pace, which favours a more cautious monetary policy approach. We still think the BoE will hike by 25bp on 23 March, but the market's pricing for an additional 50bp of tightening after that seems too aggressive.

Today, we'll hear from BoE official Andrew Houser, while the UK calendar only includes the final PMI read. EUR/GBP may continue to find support beyond the 0.8900 level for now as the euro may gain more momentum in the crosses and unstable risk sentiment should hit GBP harder.

Francesco Pesole

⬆️ CEE: Rating reviews in Hungary and the Czech Republic

Today's calendar offers less interesting data such as the trade balance in Hungary and the final GDP numbers from the Czech Republic. The Czech GDP report will likely confirm the previously published flash estimate that the economy declined in the fourth quarter of last year, making it two consecutive quarters of decline, pushing the Czech economy into a mild recession. The recession has mainly been driven by a continuous strong decline in consumer spending as households are facing the burden of high energy prices on their purchasing power.

However, the main topic will come after the end of trading. We have two interesting rating reviews in the CEE region today – Moody's in Hungary and Fitch in the Czech Republic. More interestingly, Hungary received a negative outlook and rating downgrade recently from Fitch and S&P and we expect a negative outlook from Moody's as well today. In the Czech Republic, Fitch already downgraded the outlook last year to negative. In our view, the risk of a rating downgrade has diminished since the last review in October but is still significant.

The situation in the FX market in the CEE region remains complicated. On the one hand, the return of US dollar strength has led to a retracement of previous gains in the region, but at the same time we have seen another rise in market rates that could help FX in CEE to gain again. Of interest in this context will be the Czech koruna, whose market interest rate has jumped by 20bp at the short end of the curve versus euro rates. If the US dollar allows, we should see the koruna retest new gains today on the way to 23.30 EUR/CZK. The Hungarian forint could move back below 375 EUR/HUF, however Moody's rating review should bring the topic of EU money and the delay in accessing it back on the table which should bring the forint back to 380 EUR/HUF.

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