

FX Daily: The waiting game is on

Now that markets have absorbed hawkish reactions by central bankers after the latest rate announcement and data releases, the focus will shift back to data. We think the dollar may lack clear direction until next week's inflation data. Canadian jobs numbers have the potential of driving large CAD swings today



➔ USD: Lack of direction

The dollar is struggling to find clear direction in the current market environment. Federal Reserve officials continued to push their hawkish rhetoric this week but had to implicitly and explicitly acknowledge more evidence from data must be gathered before debating the size of further tightening. This is essentially leaving the market with one conviction - a 25bp hike in March - and one outstanding doubt about whether that will mark the peak. Fed funds futures are mirroring this uncertainty by pricing in a 5.14% peak rate.

We suspect key dollar crosses will stay rangebound until the next key data releases. While today's University of Michigan survey could have some market impact, next week's CPI is the real risk event. And if the general risk environment proves resilient for another session today, the dollar should still find a floor on the back of some defensive positioning ahead of next week's inflation data, as happened in the run-up to the Fed meeting.

Fed communication remains important, but secondary to data. After all, markets have already had the chance to assess the reaction function of the Fed to strong economic data after the latest jobs report and another round of Fedspeak. Additional policy remarks from the Fed's Christopher Waller and Patrick Harker today are not likely to be a game changer for the dollar. DXY may keep hovering around the 103 handle into next week's CPI report.

The latest jobs figures in the US likely raised the bar for a positive surprise in Canada today, even though the consensus is centred on a rather small increase in the headline hiring figure (+15k). Unlike the Fed, the Bank of Canada has signalled its tightening cycle is probably over, even though it left the door open for more hikes should data argue against the disinflationary narrative. Markets are pricing little to no chance of further rate hikes, but equally seem reluctant to factor in any rate cuts by year-end.

This leaves some room on both ends for a pronounced CAD impact from a data surprise today. A weak number could fuel easing bets (risk of cuts is higher than expected anyway, in our view), while a strong number – paired with the recent revision higher in Fed rate expectations – could encourage markets to contemplate one last hike by the BoC. We still expect USD/CAD to test 1.3000 in the coming months, but the key driver may be USD weakness rather than loonie outperformance.

Francesco Pesole

➔ EUR: Rangebound for now

A brief rally failed to propel EUR/USD back above 1.0800 yesterday, and the pair may mostly trade in the 1.07-1.08 range until next week's data offers clearer direction to the dollar. Despite an improved risk environment helping the pro-cyclical euro, below-consensus [inflation in Germany](#) yesterday may have made investors more cautious about another EUR rally.

In this sense, the ability of European Central Bank speakers to lift the euro appears diminished. One of the most prominent hawkish voices in the ECB, Isabel Schnabel, will participate in a live Q&A today, although her message on the need for more tightening has already been passed through to asset prices. Pablo Hernandez de Cos is also scheduled to speak today.

Elsewhere in Europe, Norwegian CPI saw a significant upside surprise. We expect a final 25bp hike at the March meeting, though the surprise surge in underlying inflation suggests the committee could add another 25bp move in June. However this is only one input into Norges Bank's thinking, and the fall in oil prices since the middle of last year, and the fact the Fed is reaching the peak, suggest Norway is unlikely to move as aggressively as some of its European peers over coming months.

Francesco Pesole

➔ GBP: First-quarter contraction looks more likely

The UK [published GDP numbers this morning](#) and it's a very tough read. Most, if not all, of that 0.5% contraction can be blamed on either strikes (transport & health were both heavy drags) or a lack of Premier League football games in December due to the World Cup. However, the fact that the weakness in the fourth quarter was concentrated in December means the starting point for the first quarter is lower, and almost certainly means we'll get a contraction even if activity

through the quarter effectively stagnates. Our own view is we'll get a 0.3-0.4% fall in GDP in the first quarter, and probably a slight fall in the second. Recession still looks narrowly the base case.

However, next week's wage figures are what the Bank of England policymakers will watch much more closely as they assess signs of "inflation persistence". As discussed by our economics team [here](#), wages and developments in the service sector can make or break a March rate hike. For now, our house call is one last 25bp increase in March.

EUR/GBP seems to have lost some of its bearish momentum. As discussed recently, we do not see clear drivers of GBP outperformance and a return to levels above 0.8900 in the pair is our base case.

Francesco Pesole

CEE: Inflation reminder

Today, we have the first January inflation figures in the calendar. In Hungary, inflation rose from 24.5% to 25.7% year-on-year, beating all estimates, which means an upside surprise by 0.5pp. Later, we will see inflation in the Czech Republic, also expected to rise from 15.8% to 17.6% YoY, above market expectations. As always in recent months, the main issue is energy prices, which we believe saw a massive repricing in January. Also today, the Czech National Bank will publish the minutes of its last meeting as well as the complete new forecast including the alternative scenario preferred by the Board at the moment. This assumes a longer period of stable rates and a first cut only at the end of the year.

In the FX market in the region, global factors were again in charge in recent days and apart from the Polish zloty, the CEE region returned to gains. The turnaround in EUR/USD together with gas prices testing new lows and further improvement in sentiment in Europe drove the Czech koruna and Hungarian forint to new lows against the euro. Moreover, higher inflation today should support domestic rates in our view and support both currencies. However, in both cases we see heavy long positioning already, which will make the path to further gains more complicated.

Frantisek Taborsky

Authors

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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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