

FX Daily: Three key themes for this week

Three threads are influencing market sentiment at the start of this week. First, Friday's very strong US jobs data, which now puts more pressure on Powell to sound less relaxed on lower rates. Second, the setback in US-China diplomatic relations, and possible negative impact on sentiment. Third, speculation on the next BoJ governor. USD may find support



Reports suggest Masayoshi Amamiya has been approached to become the next Bank of Japan governor

USD: Upside risks this week

Three key themes are highly influencing the market mood at the start of this week: 1) Friday's very strong US jobs data; 2) US-China tensions over the Chinese air balloon; 3) reports about the next Bank of Japan (BoJ) governor.

The January jobs report in the US on Friday smashed expectations, showing a half-million increase in employment and the jobless rate falling to 3.4%. As highlighted by our US economist [here](#), such a strong print surprisingly – but clearly – signals employers are still willing to hire despite multi-month falls in industrial production, residential construction output and disappointing consumer spending. One silver lining is that the wage growth slowed from a revised 4.8% to 4.4% year-on-

year, a signal that firms are able to hire without offering meaningfully higher salaries despite the very tight labour supply.

Still, this is clearly an inflationary jobs market on paper, and a 25bp hike by the Fed looks highly likely now. Fed Chair Jerome Powell in last week's post-FOMC press conference outlined a potential "goldilocks" scenario where inflation declines without a material rise in unemployment. We'll see how much confidence he has in this scenario tomorrow as he speaks at the Economic Club of Washington. A rate protest after the post-FOMC market reaction may signal the Fed is not as relaxed as it may have sounded last week about loosening financial conditions. More Fed speak is scheduled for the rest of the week.

The data calendar is rather quiet in the US this week, which leaves geopolitical themes more space to drive market sentiment. Hopes of an improvement in US-China relations have plummeted after the US shot down a Chinese air balloon which they claim contained spy equipment. China has reiterated it was a civilian aircraft that had strayed off course and reached US airspace, and has threatened retaliation.

This looks like a major setback in what may have been an important bullish driver for global risk sentiment in 2023, as Beijing's relationships with the West appeared on track for some relaxation at the same time as China's reopening of the economy was happening. A rebound to the 6.85-6.90 area in USD/CNY could signal markets are effectively moving to discount more negative trade implications for China, which would buck the recent bullish trend on Chinese sentiment.

Finally, USD/JPY briefly traded above 132.00 in early Asian trading after reports that Bank of Japan deputy governor Masayoshi Amamiya was approached by the government to become the next BoJ governor. He was largely seen as leaning on the dovish side and more likely to favour a continuation of Haruhiko Kuroda's loose policy rather than deploying those structural changes to the yield curve control markets have been speculating on. It is too early to draw conclusions on this, and both data and market dynamics may have a bigger say on potential BoJ policy changes than the new governor: for now, however, markets may be more reluctant to add bearish Japanese government bond (JGB) positions, and USD/JPY could find some support.

All in all, these three themes appear to be pointing primarily at upside risks for the dollar this week. We think DXY could consolidate around the 103.00 mark until new first-tier data in the US are released next week and could reignite the re-rating of US growth and Fed rate expectations.

Francesco Pesole

📉 EUR: ECB hangover effect

This is also set to be a much quieter week in the eurozone. The big rally in EZ bonds after ECB President Christine Lagarde failed in her rate protest last week is another signal that the ECB has lost its grip on the rate market, and this is not great news for the euro. As discussed in our latest [EUR/USD note](#), this could mean that another large EUR/USD may need to wait until the second quarter, when US short-term rates look more likely to drop and markets may gradually align with a "higher-for-longer" narrative by the ECB.

Comments by ECB officials are the most interesting risk events to follow in the eurozone this week. We'll hear from Robert Holtzmann this morning and from François Villeroy, Isabel Schnabel, Klaas Knot and Luis de Guindos over the next few days. Given the ongoing correction and soft

momentum in EUR/USD, support around 1.0730-1.0750 in the pair would already be a welcome development for EUR bulls. Remember that the euro is highly exposed to a worsening in Chinese sentiment. We think that any rebound may lose steam around the 1.0870-1.0900 area.

Elsewhere in Europe, the Riksbank will announce policy on Thursday. We expect a 50bp rate hike as inflation remains high and wage negotiations should boost wage growth, but the recent deterioration in the economic outlook and housing market instability warns against much more tightening beyond this point. EUR/SEK still faces upside risks this week, even though we remain bearish on the pair in the medium term.

Francesco Pesole

📉 GBP: Growth data in focus this week

Growth data is the highlight of this week's UK calendar. Our economist expects the British economy to have narrowly avoided a technical recession in the fourth quarter. Still, a 1Q23-2Q23 recession is more than possible, although that could be milder than previously expected thanks to lower energy prices.

Today, we'll hear from Bank of England's Catherine Mann and Huw Pill, who may start to address the market's perception that last week's 50bp hike was a dovish one, and that the BoE is very likely close to the peak in rates. Governor Andrew Bailey will testify before Parliament later this week.

So, growth data and BoE speakers will be the two domestic inputs for the pound this week, although global risk sentiment, geopolitical developments and a supported dollar may work against any positive domestic news. Cable may heavily test 1.2000 soon.

Francesco Pesole

➡ CEE: Inflation numbers as opportunity to reassess dovish expectations

This [week](#), we start with hard data from the economy in the CEE region. Today, we will see industrial production in the Czech Republic, which we estimate accelerated slightly in December. Tomorrow, we will see the same figure in Hungary, but there we expect a decline in the annual growth rate. The National Bank of Poland will meet on Wednesday and the National Bank of Romania on Thursday. In both cases, we [expect](#) rates to remain unchanged, in line with market expectations. Thus, the main focus this week will be on the inflation prints published on Friday. In Hungary, we expect inflation to increase from 24.5% to 25.5% YoY in January, above market expectations. In the Czech Republic, we forecast an increase from 15.8% to 17.6% YoY, also above market expectations. Also on Friday, the Czech National Bank will release the minutes from [last week's meeting](#) and the full new forecast, including the alternative scenario, which is currently the board's preferred path.

In the FX market, generally good conditions persist for the CEE region, however, we may see a delayed negative reaction to Friday's downward slide in EUR/USD, especially in the case of the Hungarian forint and the Czech koruna at the start of the week. Nevertheless, we expect a rather quieter week. Friday should be more interesting as we expect inflation numbers to provide an opportunity for the market to reassess current dovish expectations, which should support the falling interest rate differential and support FX. Overall, however, we expect more of a stabilisation

around current levels. We see a range of 23.80-24.00 EUR/CZK for the koruna, 388-390 EUR/HUF for the forint and 4.68-4.70 EUR/PLN for the zloty.

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