FX Daily: Two more reasons to hold dollars

The dollar is doing a little better and equity markets are a little softer after the Federal Reserve pushed back against early easing and US regional banks again hit the headlines. Softer CPI trends in Europe and a less hawkish stance from the Bank of England should be the story in Europe today and keep the dollar relatively bid across the board

USD: Fed and regional bank stress add to dollar's appeal

As we discussed in our FOMC review comment, the Fed's pushback against a March cut has helped short-dated US rates edge a little higher and offered some support to the dollar. The strong message coming across from the Fed yesterday was that inflation and growth were moving into 'better balance', rate cuts would likely be coming but more data was required to give the Fed confidence to start the cycle. Beyond tomorrow's nonfarm payrolls data, we think the annual CPI benchmarks revisions on 9 February and the January CPI release on 13 February are now going to be big dates in the Fed's and investors' diaries.

Also making an appearance on the market's radar yesterday were US regional banks. New York Community Bancorp's (NYCB) share price was marked down heavily on poor quarterly earnings, with some of the large loan loss provisions being linked to the Commercial Real Estate sector -

perhaps the Achilles Heel of the strong US story. This comes at a time when the Fed's emergency Bank Term Funding Programme (BTFP) is due to expire on 11 March. Investors will certainly heavily scrutinise this story, but those of a bullish disposition will be expecting that the US authorities, including the FDIC, would never have allowed NYCB to take over the assets of the failed Signature Bank if it were not in a strong enough position to do so.

That said, we did notice a 7bp widening of the 3m EUR/USD cross-currency basis swap on the NYCB news yesterday. Recall that this represents banks paying up to secure dollar funding and is normally associated with dollar strength. If the US regional bank crisis flares up again, keep a close watch on this basis swap, where the dollar may initially strengthen until the Fed calms funding conditions down again.

For today in the US, the calendar focuses on initial claims and ISM manufacturing. We doubt these will prove major market movers ahead of tomorrow's US NFP release. This means that DXY should continue to grind higher towards the upper end of a 103-104 range.

Chris Turner

EUR: Soft January CPI to keep the pressure on the ECB

EUR/USD has ground lower to 1.0800 - helped by the Fed and the more risk-off tone in the market. The highlight of today's eurozone data calendar is the January CPI release where the headline rate is expected to fall to 2.7% year-on-year and core to 3.2% YoY - the latter the lowest since March 2022. Given the successful disinflation trends and weak activity data, it is therefore more difficult for the European Central Bank than the Fed to push back against early easing expectations. That is why markets still attach a 60% chance to an April rate cut from the ECB. EUR/USD support is currently under pressure at 1.0790/1.0800 and a break opens up the 1.0715/25 region.

Elsewhere, we also have an important Riksbank policy meeting today. This is the first meeting since 23 November – a meeting where the Riksbank surprisingly left rates on hold at 4.00% but left the door open for a further hike in the early part of this year. Even though the format change of these meetings suggests there will not be the usual multi-quarter forecast for the policy rate, presumably the statement itself (or perhaps the Monetary Policy Report) will make it clear that the tightening cycle is over.

However, with the Riksbank still a little wary over the performance of the krona – and with Riksbank FX hedging sales coming to an end shortly – the Riksbank may want to push back against expectations of early easing. Currently, the market is pricing 15bp of rate cuts over the next three months and 60bp of cuts over the next six. Assuming the Riksbank manages easing expectations appropriately, we think EUR/SEK will continue to trade close to our end 1Q24 target of 11.30. We are still bullish on the undervalued krona this year and retain a 10.70 forecast for year-end.

Chris Turner

GBP: BoE should signal tightening cycle is over

In our preview comment for today's Bank of England policy meeting, we felt there were downside risks to sterling. These would emerge from both the BoE dropping its tightening bias and the voting structure shifting from a 6-3 (three for a hike) to a 9-0. We rarely hear from the BoE so in a way, this would be the BoE's chance to play catch-up with some of the dovish rhetoric being used by both the Fed and the ECB. We mentioned in our preview that the FX options market was only pricing in a narrow range for today's event risk, which means that GBP/USD could be just a 1.2600 story if we are right with our dovish leaning today.

We will get this wrong if the BoE wants to emphasise sticky services inflation and if one or two of the hawks continue to vote for rate hikes. Currently, the market seems to price the first BoE cut for June. We think the easing cycle is more likely to start in August.

Chris Turner

CEE: Maybe too much local currency strength in the region

This morning we will see PMI numbers across the region. Given the improvement in sentiment in Germany and the euro area, we expect a January improvement in CEE as well. Later today, the Czech Republic's January state budget numbers will be released, which should show the start of fiscal consolidation, resulting in lower Czech government bond supply. Although the PMIs may bring some good sentiment to the markets, the focus will clearly be on the echoes of yesterday's Fed meeting.

The impact on the CEE region is unclear ahead of today's market open given the volatile reaction of global markets yesterday. The zloty and the forint rallied a lot in the last two days, and we think that is enough for now. Moreover, PLN may have strengthened too much and rates point more towards levels around 4.340 EUR/PLN as we mentioned yesterday. In addition, President Andrzej Duda signed the new budget but sent the proposal to the Constitutional Tribunal, which does not have much economic impact for now but signals that the political situation has not calmed down. This could again trigger risk-off sentiment in Poland.

EUR/CZK moved briefly to 24.90 after yesterday's comments from the deputy Czech National Bank governor about the possibility of a 50bp rate cut next week. Despite rates falling, the interest rate differential didn't move that much in the end. Therefore, we do not expect further upward movement for now and prefer to stabilise around 24.80 EUR/CZK.

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