

FX Daily: Waiting on central bankers to shake data-resistant markets

Investors have cemented Fed easing expectations despite some hotter-than-expected US data. We suspect a market reluctant to price out rate cuts will need strong words from the Fed – perhaps Powell himself – to reconnect rate expectations with data. Meanwhile, USD may stay rangebound. This week, Lagarde will speak in Davos, and UK CPI should slow further



USD: Rate expectations still disjointed from data

The first half of January has shown a dislocation between rate expectations and data in the US. The two most important data points for the Federal Reserve, labour and CPI inflation figures, both came in hotter than expected. PPI was a bit softer than consensus on Friday, but that is not enough to justify markets' reluctance to price out Fed easing. The Fed funds future curve prices in 21bp of cuts in March, and 168bp by year-end.

Our view remains that the Fed won't start cutting before May, and that the total easing package will be 150bp. Accordingly, the rally in short-term USD rates appears overdone, and weakness in the front part of the USD curve should support some recovery in the dollar. However, we suspect

that the data may prove insufficient to trigger a USD rebound for now; the consensus view of a dollar decline later this year seems to be making investors keen to sell dollar rallies. Also, the Fed probably needs to send a clearer message that the latest data does not justify the kind of aggressively dovish view embedded in money market pricing. There are a few more Fed speakers lined up this week, but perhaps dollar bears will want to hear it from Fed Chief Jerome Powell, who is not scheduled to speak until the 31 January FOMC announcement.

Incidentally, the US data calendar isn't very busy this week. Retail sales and the University of Michigan inflation expectations will attract the most attention along with jobless claims - which came in well below expectations last week, reinforcing the narrative of a still-tight labour market. We think the dollar will be driven more by other events than data this week, barring major surprises. First, the results of the election in Taiwan have raised again the delicate question of Taipei-Beijing relationships, with tensions among the two seen as a major risk for Asian and global risk sentiment this year. The dollar might benefit from some outflows from exposed EM FX. The situation in the Gulf also looks rather volatile after the US and UK military operations last week, even though the impact on oil prices has been muted so far.

Domestically, we'll monitor the market reaction to the business tax relief extension currently being discussed in the US Congress. The impact of fiscal support may turn out to be negative for risk sentiment - and positive for the dollar - as markets see a greater risk of sticky inflation and a lower chance of Fed rate cuts.

We think the dollar is more at risk of a rebound than a further correction from these levels, although the chances of another rangebound trading week in FX (DXY still hovering in the 102/103 region) are high.

Francesco Pesole

📌 EUR: Lagarde may sound more hawkish in Davos

The data inputs for EUR/USD will mostly come from Germany this week, with 2023 GDP figures today and the ZEW survey tomorrow along with final CPI numbers. We have often discussed how European Central Bank rate cut expectations appear way too aggressive (150bp by year-end), although the dovish members of the bank have failed to deliver a coordinated pushback.

Despite ECB hawks' protests against dovish expectations having had little impact on the market, the WEF event in Davos this week - which sees many ECB speakers including President Christine Lagarde - should not be overlooked. Lagarde has a greater potential to influence markets given a clearly divided Governing Council, and we suspect that she will opt for a more hawkish tone compared to last week's comments. There may be some help for the euro coming from Davos, although we should be wary. Fed expectations have been resistant to data and the same could hold true for the ECB as well. The minutes from the December policy meeting are also released this week. We still think it is premature for EUR/USD to trade sustainably above 1.10.

Elsewhere, Sweden published inflation figures today. CPIF declined to 2.3% from 3.6% (consensus 2.2%), although the core measure excluding energy remained high, slowing from 5.4% to 5.3% versus a consensus of 5.2%. Despite this, it remains unlikely that the Riksbank will tighten policy again. If anything, this modestly raises the chances that another round of FX sales will be started after the current reserve hedging programme ends in early February (in our view).

Francesco Pesole

📉 GBP: Services inflation to stay above 6%

The data flow picks up this week in the UK, with labour (Tuesday), CPI (Wednesday) and retail sales (Friday) statistics for the month of December being released. Services inflation is what matters the most for the Bank of England at the current stage and we expect to see it at 6.1% this week, considerably below the Bank of England's estimates. Despite the improvement in services disinflation, 6%+ remains too high and is unlikely to make the BoE endorse dovish rate expectations just yet.

EUR/GBP can retest the 0.8573 lows, but we expect it to find a bit more support this week as the euro may benefit from some hawkish comments by Lagarde in Davos. Our medium-term view on the pair remains bullish.

Francesco Pesole

📉 CEE: Sinking beacon of hope

After a very busy calendar last week, this week we take a little break in the CEE region. The final December inflation numbers in Poland will be released today and core inflation tomorrow. We do not expect any changes in the headline rate and anticipate a drop in core from 7.3% to 6.9% year-on-year. On Wednesday, we will see PPI numbers in the Czech Republic, one of the last numbers before the February Czech National Bank meeting. Thursday will see the release of industrial production in Romania and PPI in Poland on Friday.

Otherwise, we will continue to monitor the dynamic political situation in Poland. The state budget draft for this year will be discussed this week in parliament. In the Czech Republic, we are getting closer to that CNB meeting and we should hear more from the board in the next two weeks before the blackout period begins. After surprisingly low inflation for December, there is the possibility of a rate cut of 50bp instead of 25bp, which is our base case scenario here for now.

CEE FX remains the last island of resistance within the EM space, which is under selling pressure this year. However, last week proved that the CEE region is not the exception and bearish sentiment has arrived here, too. The market is starting to price in more cutting than we expect, not only due to global direction but also inflation surprising to the downside. And even in Poland, where the central bank continues its hawkish tone, FX has not escaped losses. Despite the inflation surprise in the Czech Republic, we believe the koruna will remain resilient and should not go to the 24.700-800 range. On the other hand, Hungary's forint has been ignoring rapidly falling rates for some time, which we believe leaves HUF vulnerable, and we expect rather weaker levels this week above 380 EUR/HUF. Poland's zloty remains the only currency in the region supported by a higher interest rate differential. However, political noise seems to be entering the market and PLN is rather weaker. Therefore, we see EUR/PLN around current levels for the next few days despite positive market conditions.

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