FX: USD rebound should not last long

The knee-jerk reaction to the Fed has been a higher US dollar but we expect this positive effect to fade soon

Source: iStock

USD: The dollar rebound should not last for long

The FOMC meeting did not bring any major surprises, with the Fed further confirming the gradual (and well known) path towards monetary policy tightening (see US Fed: Subtle changes hint at upside risks to rates). While the knee-jerk reaction has been a higher USD, we expect the positive effect on USD to fade rather soon. Not only is there already a fair degree of tightening priced in (see below), but synchronised economic recovery elsewhere (with the rest of world catching up with the US) and still very much present US political uncertainty (ie, the potential for another, more damaging, government shutdown this month) suggest that the overnight USD strength is unlikely to transform into a trend.

EUR: EUR/NOK to continue its deprecation trend

While the FOMC statement had a mildly negative impact on EUR/USD we don't expect it to last as (a) a fair degree of FOMC tightening is priced in for this year (in excess of three hikes); (b) the general risk environment remains buoyant. The latter is EUR supportive with EUR/USD sensitivity to risk rising meaningfully recently (see EUR/USD close to 1.23 is still undervalued). The likely solid Norway January PMI should add support to the Norwegian krone and push EUR/NOK below the

9.5500 level again. With oil prices high and resilient, EUR/USD rising (thus supporting all European currencies), the Norges Bank no longer dovish and with the krone still materially undervalued, the shift in sentiment towards NOK is very clear.

GBP: Solid Manufacturing PMI vs transition deal negotiations

In the UK, the focus turns to the January UK Manufacturing PMI. The reading should remain solid, reflecting a broader strength in other UK data, benefits of softer GBP and the ongoing global recovery. We expect a limited spill over into GBP as the Brexit negotiations (namely the road towards a transition deal agreement) should be the key GBP driver in coming weeks and months.

CZK: Rate hike priced in, the key CZK driver is the new CNB EUR/CZK forecast

We and the market expect the Czech National Bank to hike rates by 25bp today (see CNB Preview). But this is largely priced in and should have limited impact on EUR/CZK. Rather the focus will turn to the new CNB interest rate forecast as well as the new EUR/CZK projection. On the latter, we expect the CNB to forecast EUR/CZK around/below the 25.00 level by the year-end and should partly offset the potential negative stemming from the dovish interest rate forecast (of two hikes this year), in turn keeping the case for well-behaved and gradual EUR/CZK downtrend in place. EUR/CZK to test the 25.20 level today.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com