FX Daily: Flip Flop

Markets continue to be bounced around by data and central bank speak. Friday's surprisingly strong US jobs data questions the Fed's view that the labour market is coming into better balance. This week, the focus will be on US ISM Services and some important CPI revisions. Look out also for rate meetings in Australia, Poland, the Czech Republic and Mexico

USD: A staggering US jobs report

As James Knightley wrote in his review of the US January jobs report, it was strong across the board. Strong payroll gains, a decent spread of industries hiring, lower unemployment and higher wages. The only whisp of grey cloud was the average work week falling. Financial markets, however, looked at these strong numbers and sold bonds and bought the dollar. Once again, the US yield curve flipped back into bearish flattening mode, which is bullish for the dollar against the activity currencies – i.e. commodity and emerging market currencies usually underperform.

This data clearly pushes back against the overriding narrative that the Fed will cut rates early and knocks a March cut off the table. By the close of play Friday, investors assigned around a 20% chance to a March rate cut – down from 50% a week earlier. The wild card to this Fed story remains the commercial real estate sector, where any regional bank stock coming under severe pressure does see early Fed easing being repriced. That is the risk rather than the base case, however. We look for the first Fed rate cut in May.

Turning to the week ahead, today, we see the ISM services data. This is expected to pick up to 52.0 from 50.5. Recall that around the turn of last year, this number plunged. However, that number proved a false flag for a slowdown, and equally, we suspect any soft number today will not be able to turn around Friday's price action in financial markets. And on Friday this week, we will see revisions to the 2023 US CPI series. The Fed's core message at the moment is one of needing the confidence in the disinflation process to cut. These benchmark revisions pose the slight risk that the late 2023 welcome disinflation trend gets revised away – which would be dollar-positive and risk-negative. So, it is certainly an event risk to watch carefully.

In other markets this week, we may see some Reserve Bank of Australia pushback against easing expectations when it meets on Tuesday, and on Thursday, we have rate meetings in India and Mexico. With trading partners to the south slashing interest rates, the market is looking for signals that Banxico is ready to pull the trigger. Even if it sent some signals to that effect – e.g. one member of the Governing Board voted for a cut – we doubt the peso would have to sell off too hard.

Back to the dollar. Expect more of this low volatility range-bound trading – 104.00/104.25 on the topside and maybe now 103.20 on the downside for DXY.

Chris Turner

EUR: Fewer inputs this week

The strong US jobs data swung EUR/USD back under 1.08. Investors have learned not to chase these moves, however, given the very low volatility environment. It is tempting to say the direction of travel lies to the 1.07 area, and if so, it will probably be a function of the US side of the equation. From the eurozone side, the calendar is relatively light. We have the eurozone Sentix Survey and the usual array of ECB speakers. Of note this week could be Tuesday's release of the European Central Bank inflation expectations survey. One- and three-year CPI expectations were seen at 3.2% and 2.2%, respectively, in the November survey.

Given the market still prices a 55% chance of an ECB rate cut in April, there is always a risk of a EUR-positive back-up in short-term rates if that cut is removed. It is not clear this will be the week in which the April rate cut is removed.

Chris Turner

LATAM: Quick round-up

Latin American currencies have had a very mixed 2024 so far. The 12-month outright USD/ARS still trades close to 2000 versus the official rate of 827. The kerb or blue rate remains around 1170. The new Milei administration is backing down on some of its planned aggressive spending cuts – a move welcomed by the IMF, which has recently approved a $4.7bn disbursement under its $44bn loan programme. Visibility on the path of the Argentine peso is poor, and equally, there is very little liquidity in ARS FX hedging products.

Elsewhere, the Mexican peso is the only Latin currency to be up against the dollar on a total return basis. Investors are quite rightly at this very early stage, ignoring the threat of a new Trump administration, and are happy to pick up an 11% yield on a currency powered by loose fiscal and tight monetary policy. We doubt suggestions of an early Banxico cut (see above) have to do too much damage.

Elsewhere, USD/BRL realised volatility is exceptionally low. The weak link here remains the fiscal side, where at some point the government might be forced to abandon its pledge of a primary fiscal balance at 0% of GDP this year. That is why we continue to favour BRL/MXN lower. And the worst performer in Latin America is the Chilean peso. We wonder whether the central bank will regret delivering its recent 100bp rate cut now that USD/CLP is back at 950. Recall that was the FX level that blew the central bank's plans off course last October.

Chris Turner

CEE: Turns bearish after rally

Monday's calendar is basically empty in the region, but the rest of the week will be busy. Tomorrow will see the release of a mix of industrial production and retail sales data in the Czech Republic, Hungary and Romania. On Wednesday, we will see a decision from the National Bank of Poland (NBP). In line with expectations, we expect rates to be unchanged. The reaction function has shifted since the country's elections in October from ultra-dovish to neutral. Therefore, the press conference on Thursday will be more interesting. On Thursday, the Czech National Bank (CNB) meets and we expect it will cut rates by 50bp, in line with market pricing, while surveys expect a 25bp cut. On Friday, January inflation in Hungary will be released, which is the first print in the region. The market expects it to fall from 5.5% to 4.3% year-on-year, safely below the central bank's forecast.

We are rather bearish for this week after last week's rally in the region. The main market focus will be on EUR/CZK, which broke above 24.90 on Friday. A weaker CZK may be a reason for the CNB to remain cautious and deliver only a 25bp rate cut. For now, rates suggest EUR/CZK should return to 24.90, but a stronger USD leaves the CZK exposed to further weakness as well as the region. PLN and HUF rallied a lot last week and probably too much, as we mentioned earlier. In addition, rates for now have not caught up with the movement in core rates after Friday's US jobs data. This leaves them exposed to weakness. We prefer PLN in this pair, which should be supported by stable NBP rates. HUF, on the other hand, should suffer further due to the more rate cuts pricing, especially after Friday's inflation print. Therefore, PLN/HUF could see some gains again after a few days' pause.

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