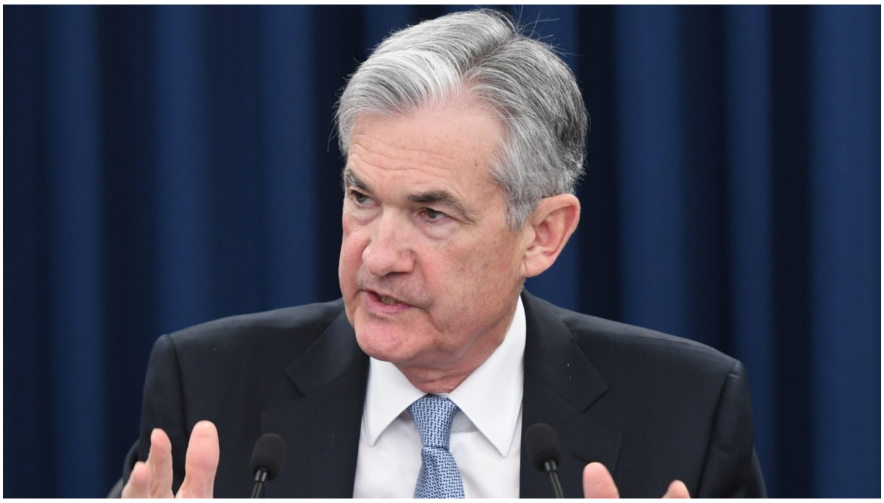
USD: Cautious Fed to support risk appetite

The Federal Reserve's signal to end the balance sheet reduction should be seen as supportive for risk, in our view



Source: Federal Reserve

USD: Cautious Fed to keep risk appetite supported

The FOMC minutes reiterated the Federal Reserve's cautious message. While the minutes revealed that a rate hike is still on the table (which has been perceived as hawkish by some given that the market is pricing in a partial cut next year), we note that for the Fed to hike, the external environment and risk assets would need to remain stable, meaning that an eventual hike is not inconsistent with a benign environment for risk and emerging markets FX. The hint to end the balance sheet roll-down later this year should be seen as supportive for risk, in our view. With the Fed no longer on autopilot and being responsive to the external environment, we remain constructive on high yielding EM FX.

EUR: Will PMIs show signs of bottoming out?

All eyes will be on the eurozone February PMI data today. After a deterioration in forward looking indicators, our economists look for some stabilisation today with readings remaining in expansionary territory. This may give the euro some breathing room and offer hope that eurozone data is bottoming out (after previously being negatively affected by some by one-off factors). Constructive PMIs would cause EUR/USD to re-test yesterday's high of 1.1371 and be positive for central and eastern Europe FX.

GBP: Waiting for more tangible signs of progress

EUR/GBP continues to hover around the 0.8700 level as, after expectations of meaningful progress in the UK-EU Brexit talks, very little was delivered yesterday. Moreover, even if Prime Minister Theresa May obtains concessions from the EU, the key question of whether she will be able to achieve a majority in the parliament vote next week remains. The change to negative in Fitch's outlook of the UK sovereign rating underlines clear risks from Brexit to the economy.

PLN: Zloty to continue underperforming its peers

The Polish zloty has been underperforming its CE3 peers recently, which has, in our view, been a function of diverging monetary policy prospects – as evident in the somewhat dovish comments from Governor Adam Glapisnki yesterday vs the tightening bias of the Czech and Hungarian central banks. With EUR/PLN not screening meaningfully overvalued based on our short-term financial fair value model, we don't see much scope for the zloty to catch up with its CE3 peers at this point. While Polish retail sales in January should rebound from 4.7% to 8.0% year-on-year today, it is unlikely to translate into idiosyncratic PLN strength, as the spillover to monetary policy is non-existent. Near-term, PLN should continue underperforming the Hungarian forint and Czech koruna, while EUR/PLN price action should be primarily a function of eurozone data (such as today's PMIs, where hopes of bottoming out may support the zloty).