FX Daily: Dollar rebound unlikely to have legs

We don't expect the dollar rally prompted by high US April CPI to have persistent legs as imminent Fed tightening is unlikely and the deeply negative front-end US rate should dominate and weigh on USD. DXY to move below 90.00 in the coming weeks. Elsewhere, Banxico to remain on hold, with its non-dovish language providing support to MXN

USD: Dollar rebound unlikely to have legs

The material upside surprise in the April US CPI yesterday weighed on risk sentiment, boosted the dollar and sent cyclical FX lower. Although the reaction yesterday was meaningful, price action already normalised overnight, with the G10 FX segment broadly flat vs USD. While surging prices are a clear world-wide phenomenon and we agree that the Fed will have to hike earlier than it currently indicates (possibly in Q1 2023 rather than in 2024 as the Fed currently forecasts) an imminent tightening from the Fed seems unlikely. This means that in the coming months, the prime USD drivers should be deeply negative front-end real rates and the rebounding global economy. We are thus inclined to think that the sell-off in FX markets yesterday should not have persistent legs and that DXY is set to head below the 90.00 level in coming weeks

EUR: Downside to the EUR/USD should be limited

We expect EUR/USD not to dip below the 1.2000 level and the upcoming improvement in the EZ economic data should keep appreciation pressure on the cross. Despite the recent spike in US yields (and the subsequent decline in our estimate of the EUR/USD short term financial fair value) and the non-negligible rise in EUR/USD spot since early April, EUR/USD is trading in synch with its short term fundamentals, suggesting limited scope for further downside. In line with the CEE trend, Romania April CPI rose further this morning (to 3.2%YoY). But with the FX pass-through being the highest in the region and the meaningful adjustment in the EUR/RON trading corridor higher already happening in Q1, high prices suggest stability in EUR/RON, making the currency attractive from the carry point of view

GBP: More gains still ahead

The better than expected March UK GDP yesterday underscored the bright outlook for the pound and the expected solid UK data this quarter should further support the currency. We expect EUR/GBP to re-test the 0.8500 level in the coming weeks. After the latest dip in GBP speculative positioning, sterling longs should start increasing yet again

MXN: Banxico to talk tough

Banxico meets to set interest rates today. Ideally Banxico would like to extend its 425bp easing cycle below the current overnight rate of 4.00%. But the window to do that has closed. And the FX market warmly greeted the news in March that the decision to hold rates at 4.00% was unanimous. Since that meeting price pressures have only increased. CPI has now risen to 6% YoY and inflation expectations, through the 5-year linkers, have now risen to 4.4% - the highest since early 2017. Amidst this backdrop and Banxico's over-riding mission statement of getting inflation back to its 3% target, we expect Banxico to talk tough today. The market currently prices a 50bp hike in the policy rate by year-end and we doubt Banxico will want to disavow the market of this notion. We like the MXN and assuming Banxico is a little more hawkish and that US Treasury yields do not do too much damage, we'd expect fresh selling interest to emerge in USD/MXN in the 20.30/40 area.

Authors

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com