FX Daily: EUR/$ to show more resilience

FX continues to be driven by gyrations in the US Treasury markets, where there is a strong consensus for higher yields. Yet the broadening European recovery means that EUR/$ should be better placed to withstand higher US yields than it was in February and March. Look out for month-end flows around the 4pm London fix, which may be $ negative.

USD: Month end flow may be dollar negative

Dollar losses post a benign FOMC meeting proved relatively short-lived as US Treasury yields rose yesterday. US Treasuries remain the biggest thorn in the side of dollar bears like ourselves. Clearly, with commodities surging around the world and the US economy having the smallest output gap amongst the advanced economies, the scope for a pick-up in inflation in the US is high. A Fed refusing to shift the narrative on transient inflation does leave the Treasury market vulnerable to episodic bouts of selling - and trying to pinpoint when they occur remains a challenge, to say the least. Yet it is not a one-way street for Treasuries and our colleagues in Rates Strategy point out demand for Treasuries is emerging from the pension fund community. Equally, we would say that the rest of the world looks on a slightly firmer footing to absorb the rise in US Treasury yields than it did in the more uncertain environment of February and March. In short, we think the out-performance of pro-cyclical currencies (those exposed to the global business cycle) should be a core theme for the rest of the year, despite concerns about higher US yields. For today, March US personal income data may be seen as old news, while final April readings of Michigan consumer sentiment should remain strong. The end of the month also warns of portfolio re-balancing flows at the 4pm London WMR fix. Out-performance of US equity benchmarks this month could lead to some dollar selling. DXY to trade a 90.50-91.00 range.

EUR: Technical recession is old news

The focus today will the first look at 1Q Eurozone GDP data, where a -0.8% QoQ decline is expected and will generate headlines of a return to a technical recession. (So far actually, France has surprised with a 0.4% QoQ growth versus flat consensus.) However, a poor first quarter has already hit the EUR and prompted last month's correction to 1.17. Instead, the forward-looking FX market can focus on the emerging positives, where sentiment indicators are rising sharply, the vaccine roll-out is gaining pace and there could be a scenario where EU Recovery Funds start to be released in July. We have also seen a relatively positive Q1 for European bank earnings so far, where loan loss provisions are being released on the back of more confidence in the recovery. Our point here is that the EUR should now be more resilient to occasional bouts of risk aversion and higher US yields. EUR/$ has had a relatively uninterrupted run higher in April and may be due some consolidation into early May - typically a stronger month for the dollar seasonally. Yet we would see EUR/USD as being supported in the 1.1980/2000 area ahead of a push to the highs of the yar at 1.2350

GBP: Financials could see FTSE play catch-up

Financials are performing well, buoyed by the releases of loan loss provisions and steeper yield curves which can take some pressure off Net Interest Margins. We note that year-to-date UK's FTSE has under-performed (+7.7%) the Eurostoxx 50 (+12.5%) and the S&P 500 (+12.2%). The UK is the most-unloved geography in buy-side surveys. Yet further out-performance of financials could see a rotation towards the FTSE, where financials make up 18% of the index, versus 14% for the Eurostoxx 50 and 11.5% for the S&P 500. Of course, there are always many risks with GBP, but we do think Cable can break above 1.40 during benign moments for the FX market. And next week's BoE meeting could prove interesting.

PLN: Polish April CPI could hit 4% YoY

Poland releases April CPI today and it could well top the consensus estimate of 3.9% YoY. With the NBP showing no signs of wanting to tighten, higher than expected inflation could feed the narrative of more deeply negative rates and put some pressure on the PLN. Yet we think this story may have more impact in the rates space, triggering curve steepening particularly in the 5s10s part of the curve. The PLN may also enjoy some reprieve from the negative real rate story given yesterday's ruling by the European Court of Justice (ECJ) that Polish courts should decide on the FX-mortgage contract issue. The Polish Supreme Court rules on this May 11th, but the ECJ decision to refer the matter back to the local courts saw Polish bank stocks jumps on Thursday - this community already having made large provisions for a negative outcome.

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