

FX Daily: A glimpse of future easing

The Hungarian forint sold off 2% yesterday after a local central banker surprised markets by suggesting Hungary could make preparations to start easing interest rates. Central banks in Eastern Europe and Latin America were some of the most hawkish heading into this cycle. Will foreign exchange markets allow them to be the first to start cutting rates?



The National Bank of Hungary in Budapest

➔ USD: Fed's Beige Book won't stand in way of Fed hike in May

The highlight of yesterday's session was a 2% fall in the Hungarian forint after a local central banker suggested that the top rate (25%) of its policy corridor could be cut at next week's policy meeting (see more on this below). While not an effective rate cut, the comments still saw 2-year Hungarian swap rates drop 50bp. We mention this here because some of the central banks in Eastern Europe (Hungary and the Czech Republic) and in Latin America (especially Brazil) were the earliest and most aggressive in their tightening cycles and a key story for the second half of this year will be whether these central banks can be the first to cut rates without their currencies selling off too hard.

The evidence from yesterday suggests foreign exchange markets remain very sensitive to any suggestions of any early easing and that there might need to be stronger evidence of the turn in

rate cycles in core markets before some central bankers in EM can push through with easing cycles.

Back to core markets and last night's [release of the Fed's Beige Book](#) ahead of the 3 May FOMC meeting did not show a material weakening in activity after the failures of two US banks in early March. Several Fed districts did note tighter credit conditions but as yet no significant weakening in activity. The report should not interfere too much with the market's 89% probability pricing of a 25bp Fed hike on 3 May and does not seem to provide much fuel yet to the bearish dollar narrative.

For today, all the Fed speakers are after the European close (Christopher Waller speaks at 18CET) and instead, the market will have second-tier data to digest such as weekly initial jobless claims and existing home sales. The Beige Book did hint at a softening in the tight labour market and any big upside jump in initial claims could be worth a 0.5% drop in the DXY dollar index - i.e. a drop back to the 101.50 area.

Chris Turner

📈 EUR: Pricing of ECB hikes edging back to early March highs

Looking at the pricing for the October European Central Bank policy meeting, we now see the market pricing the deposit rate at 3.87%. This pricing has recovered from the low of 3.00% priced on 20 March and is now not far from peak hawkishness of 4.07% priced on 8 March - before the two US banks failed.

Clearly, the market has taken the view that the US banking crisis - as yet anyway - has not been severe enough to push the ECB off course. Certainly in its recent [Global Financial Stability Report](#), the IMF made the case that euro-area banks were far less exposed to the risk of unrealised losses on Held-to-Maturity securities than the US banking system. Additionally upside inflation surprises and re-pricing of tightening cycles in European peers (UK) have also nudged ECB tightening expectations higher. This all looks supportive for the euro - as long as the ECB delivers on what is priced.

We could see some insights into the latest ECB thinking with the 1330CET release today of the minutes of the 16 March meeting. Here, the ECB pushed ahead with a 50bp hike in the midst of banking turmoil. Presumably, the ECB will be reluctant to give any signals today of an early pause. Also today, look for April eurozone consumer confidence and some more ECB speakers - Ignazio Visco (dove) at 1515CET and Robert Holzmann (hawk at 1700CET).

The ECB story is a mildly supportive one for the euro, but the international environment is yet to favour a big push above 1.10 in EUR/USD. Just look at how EM and commodity currencies have failed to advance after this week's better-than-expected 1Q23 China GDP release. And as energy markets [seem to be showing us](#), investors still seem to be focused on the global demand slowdown (\$ positive) than a forthcoming global recovery (\$ negative).

EUR/USD could drift to the top of a 1.0900-1.1000 range were US data to come in on the soft side today.

Chris Turner

➔ GBP: Re-thinking the BoE profile

Yesterday's release of higher-than-expected March UK inflation has seen the pricing of the Bank of England cycle push up to a new cycle high. The market now prices the current 4.25% Bank Rate being taken close to 5.00% by November. The BoE may not choose to push back against this pricing until the 11 May rate meeting - where a 25bp hike looks likely. Also, tomorrow does see the release of March retail sales and the April PMI numbers - which could shed light on how the economy is coping with higher rates.

With the ECB still expected to tighten more than the BoE over the remainder of this year, we would expect EUR/GBP to continue finding demand under 0.8800. But a more aggressive BoE may force us to lower our second-half EUR/GBP targets of 0.90.

GBP/USD could creep back to 1.2500 should any of today's US data add to some early indications of a slowing US economy.

Chris Turner

➔ HUF: Forint will be key for next week's NBH meeting

Yesterday, the National Bank of Hungary (NBH), specifically Deputy Governor Barnabas Virag, hit the headlines. He said in an interview that the central bank may lower the upper end of the rate corridor next week, a big turnaround from previous statements from the NBH. It seems that market sentiment has improved enough that the NBH is willing to start considering a real rate cut. For now, the main reason for these statements seems to be to test the waters and see the market reaction before next week's meeting. In our view, EUR/HUF is the main variable the central bank is watching right now. So the question is, where we will find the forint at the end of this week?

Of course, EUR/HUF has moved up significantly (+2%) after the NBH statements, but it is still not that severe. For now, the forint has moved back to the levels of early April which, looking at the last few months, is not too bad. On the other hand, the positioning is very long HUF and the forint may sell off further in the coming days. In our view, levels in the 385-390 EUR/HUF band could already be a warning sign for the central bank to reconsider some of the statements made yesterday.

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