FX Daily: A pause in the US dollar decline

The broad-based dollar decline has slowed as investors await a decision from the Federal Reserve tomorrow. But we see more weakness ahead

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USD: A pause in the decline

The US dollar bear trend paused overnight, with most G10 and emerging market currencies staying flat vs USD. Markets are likely to pause for breath ahead of the FOMC meeting tomorrow. But as the Federal Reserve is unlikely to change its stance and take the punchbowl of liquidity away from markets even as economic prospects improve, the now low-yielding USD is set to remain under pressure in the months to come. As both the USD decline and the US Treasury yield curve steepening have tentatively halted, the Japanese yen should outperform vs its G10 peers today as the yen has been the main loser from steepening UST yield curve dynamics. This means USD/JPY should continue to re-test the 108.00 support level today.

EUR: Gains stall as USD decline pauses

As the broad-based dollar decline paused, so EUR/USD gains stalled. Plenty of good news seems to be priced into EUR/USD mainly on the euro side (following the risk premium-reducing measures from the European Central Bank and various large fiscal stimulus plans announced). Based on our short term financial fair value model, EUR/USD currently trades around 3% rich on a short-term basis. More EUR/USD upside is still possible in the months to come in our view but another broad-based dollar decline is key for higher EUR/USD.

GBP: Sterling rebound is not sustainable

Sterling's gains yesterday were mainly driven by global factors and the appreciation of higher beta currencies. We still see scope for further GBP upside as limited and look for a reversal of the recent EUR/GBP drop as the UK-EU trade deal uncertainty (and its negative implication for the UK's 2021 growth outlook) weighs on GBP, with EUR/GBP moving towards the 0.91 level by month end.

HUF: Fall in CPI to further improve HUF real rate

Hungarian CPI should fall again in May, further declining below the 3% target, with the base effect being the main reason behind the CPI fall in year-on-year terms. With CPI falling rapidly and the National Bank of Hungary still not reversing the previous FX stabilising hikes, the forint continues to enjoy higher real rates than the Czech koruna or Polish zloty. The currency also remains less exposed to swings in risk appetite, as the NBH's actions from previous months supressed the forint's beta to risk. We continue to look for EUR/HUF stability, with the cross remaining around the 344 level today. During risk-off days, HUF is set to outperform both CZK and PLN given its lower sensitivity to risk and lower short-term mis-valuation.

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