

## FX Daily: Bracing for US March CPI reading

All eyes today are on the US March CPI reading, expected to hit a new cycle high at 8.4% year-on-year. A number in that vicinity should maintain aggressive Fed tightening expectations and keep the dollar supported across the board. Elsewhere, the focus will be on whether the Reserve Bank of New Zealand chooses to hike 25bp or 50bp in early Asia tomorrow



Fed dove Lael Brainard speaks at 1810CET today. She triggered a sell-off in the US Treasury market last week

### 📈 USD: High CPI to support aggressive Fed

Consensus expects today's US March CPI release to push up to a new cycle high of 8.4% year-on-year and core rising to 6.6% year-on-year. Although it seems extreme, this kind of number should support market expectations that the Fed will take the policy rate towards the 2.50% area by year-end. Notably, market-derived inflation expectations such as the 5Y5Y inflation swap forward and inflation-protected Treasuries still show longer-term inflation expectations on their highs in the 2.80-3.00% area. This will serve as a reminder that the Fed is still in the mode of gaining control of inflation expectations – i.e. sounding very hawkish.

On the subject of the Fed sounding hawkish, Fed dove Lael Brainard speaks at 1810CET today. Recall how she triggered a sell-off in the US Treasury market last week by suggesting the Fed needed to shrink its balance sheet, and fast. US 10 year Treasury yields are now close to 2.80%,

with 3.00% beckoning.

A hawkish Fed remains very much behind dollar strength – as is the war in Europe. DXY is now nudging above the 100 area and we see no reason why it cannot continue to push on to 100.80/101.00. Equally, USD/JPY has broken clear of the 125.00 area and gains could accelerate on a technical break of 125.85 – the high in 2015.

## ➔ EUR: New sanctions in focus

EUR/USD is languishing below 1.0900 and barring a surprisingly hawkish ECB meeting on Thursday, EUR/USD should stay soft. Indeed, some argue that with 65bp of ECB hikes now priced in by year-end, it is actually difficult for the ECB to deliver a hawkish surprise.

In terms of geopolitics, the world is bracing for an intensification of hostilities in eastern Ukraine. Europe has yet to go so far as to place an embargo on Russian oil, but clearly that is the risk over the coming months. Such action may cost Eurozone growth anywhere between 1% and 3% and add a new layer of bearishness to the euro.

For today, look out for another plunge in German ZEW investor expectations – perhaps matching the extreme pessimism seen in March 2020. And late next week, we will start seeing the releases for the March PMIs across Europe – which will be the first chance to look at the damage done to business confidence. EUR/USD could drift down to the 1.0800/0820 area today if US CPI sees US 10 year Treasury yields push higher and the German ZEW is as bad as expected.

## ➔ GBP: Unemployment rate dips back to pre-Covid levels

The UK has just released employment data for February, showing the ILO unemployment rate dipping to 3.8% – back to pre-Covid levels – and average earnings rising as expected back to 5.4% 3m average year-on-year. For the time being, this kind of data can probably support market expectations of a Bank of England Bank Rate above 2.00% by year-end (versus 0.75% currently). Any rude awakening for BoE policy expectations will probably have to wait for the 5 May BoE rate meeting.

We prefer any GBP strength to be played out against the euro and the Japanese yen, while cable still looks vulnerable to 1.2850 in a strong dollar environment.

## ➔ NZD: RBNZ expected to hike 25bp early tomorrow

Despite lacking the backing of fossil fuel exports, the New Zealand dollar has been one of the better performing commodity currencies this year. It has effectively matched the US dollar's advance. True it enjoys the benefit of higher agricultural prices for its dairy exports, but a key driver has been the hawkish Reserve Bank of New Zealand (RBNZ).

The RBNZ meets early in Asia tomorrow to set interest rates. Most are expecting the fourth 25bp hike, which will take the OCR policy rate to 1.25%. A few economists and the money markets believe the chances of a 50bp hike do exist as well. Holding the RBNZ back from 50bp may be the fact that this is not a meeting backed by a Monetary Policy Statement (where it might be easier to explain a 50bp adjustment) as well as the recent dip in consumer confidence.

With the US dollar expected to stay strong, there could be some downside risks to the New Zealand Dollar tomorrow should the RBNZ do 25bp and not provide more meat to market

expectations which look for the policy rate above 3% by the end of the year. A correction in NZD/USD to 0.6720/6780 looks the risk – especially with Asian FX generally on the back foot. But, medium term, we expect NZD/USD can advance to the 0.71/73 area.

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