

## FX Daily: Commodity currencies in trouble

Unstable risk sentiment and China's battle against Covid are raising the downside risks for commodity currencies. At the same time, the PBoC's tolerance to a sharp CNY depreciation may signal a regime shift towards welcoming a weaker currency again. A relatively quiet week data-wise ahead of the Fed meeting on 4 May could see the USD remain supported



China is still under a zero-Covid policy and consumption has been weak

### 📈 USD: Hard to let go of dollar defensive positions

The week is starting with a firmly negative tone in global markets, which are discounting a combination of a) many central banks accelerating their tightening plans, b) Russia and Ukraine moving further away from a diplomatic solution, c) China's Covid crisis which is forcing a re-rating of growth expectations in the region. This last theme is mostly behind the sell-off in Asian equities overnight and has forced a correction in three of the currencies that had emerged as outperformers in the first phase of the Ukrainian conflict; the Chinese yuan, Australian dollar and New Zealand dollar.

When it comes to the yuan, it will be interesting to gauge whether (or at what point) the People's Bank of China decides to step in to offer some support. Indeed, the CNY remains strong compared to 2019-2020 standards – and this is still likely welcome by Beijing as energy costs remain

elevated. But the lack of any intervention by the PBoC despite the elevated downside volatility in CNY may signal that China could be shifting to a more growth-orientated currency management (i.e. welcoming a weaker yuan) at a time when tight containment measures are posing significant risks to the country's economic outlook. Should markets receive more indications that this is the case, selling pressure on the yuan may well continue.

The commodity market is also absorbing China's growth concerns, with energy and metals facing some considerable bearish momentum. This is another channel through which AUD and NZD are getting hit. Iron ore, Australia's main export, fell by nearly 12% in early trading today before paring some of the losses, and we think the fall in AUD/USD might extend into the 0.70-0.71 area in the coming days.

Naturally, the implications of unstable risk sentiment and commodity prices correcting lower are spreading to the whole commodity FX segment, which may struggle to find any firm support in the coming days. When it comes to the dollar, Fed-induced demand for the greenback may be somewhat reduced as markets have well cemented their expectations for multiple 50bp increases but defensive dollar holdings are hardly likely to be unwound at the current juncture. Any more USD strength/consolidation may come (like we saw last week) at the expense of commodity currencies more than low-yielders.

Data-wise this week should be nothing more than a prelude to the 4 May Fed meeting, with some focus only on growth figures in the US, which should indicate an expansion at a 1-1.5% annualised rate. With the Fed firmly focused on inflation, growth data should have a limited market impact.

## ➔ EUR: No real impact from Macron's win

Emmanuel Macron has secured a second term as French president, removing a tail risk for European assets and the euro, but markets had clearly priced in little-to-no chance of a Marine Le Pen victory and the positive impact on EUR/USD was contained and very short-lived. This also indicates the lack of any material bullish sentiment on the euro (French elections could have been a good buy-the-dip opportunity), which in our view boils down to the lingering downside risks to the eurozone economy as the Russia-Ukraine conflict looks set to continue for longer, and (by extension) forced patience by the European Central Bank in its monetary-normalisation process.

The marked ECB-Fed divergence argues against any sustainable rebound in EUR/USD in our view. This is despite ECB officials having sounded more hawkish after the ECB's April meeting, simply because money markets are already pricing in three 25bp rate hikes by year-end, which is keeping the bar quite high for any hawkish surprise.

This week, the focus will be on inflation figures in the eurozone, with the headline rate expected to top March's 7.5% reading. Also in this case, the already hawkish market pricing for ECB tightening means that any upside surprise may fail to materially lift the euro. We expect EUR/USD to keep hovering around the 1.0800 level this week, although some idiosyncratic dollar strength may trigger a break below 1.0700.

## ⬇ GBP: Dealing with heavy selling pressure

A big technical break below 1.3000 on Friday triggered a sizable sell-off in GBP/USD, which is now struggling to hold on to the 1.2800 level this morning. The trigger on Friday was some weaker-than-expected retail sales figures for March, which probably fed some already ongoing re-rating of

UK growth expectations and the notion that the British economy was more insulated than other European countries from the fallout of the Ukrainian conflict.

However, this hasn't been followed by a significant re-pricing of Bank of England tightening expectations, as markets continue to fully price in six more 25bp rate hikes by the end of the year (plus a seventh one that is 80% priced in). This week, we have no major data releases to watch in the UK and the BoE is in the blackout period ahead of next week's policy meeting.

The deterioration in risk sentiment, risks of a dovish re-pricing in the BoE rate expectations and potentially some re-emergence of negative Brexit-related headlines continue to pose downside risks to the pound in the coming weeks, and a test of the 1.2500 support cannot be excluded.

## 📌 CEE: hawks gather to further raise interest rates in the region

This and next week will be dominated by central bank meetings in the region. Peter Virovacz in Budapest [expects the National Bank of Hungary to raise its base rate](#) by 100bps and deposit rate by 30bps this week. With EUR/HUF now being close to pre-election levels of 368, we don't see this meeting as being a game-changer. Although it can provide some support to the forint, we don't envision a marked strengthening here purely based on monetary policy decisions. The second half of the week marks the start of the blackout period for the NBP and Czech National Bank ahead of next week's monetary policy meetings. Thus, we expect statements from the MPCs in both cases, which should continue the hawkish tone. However, given the high market expectations, we do not expect significant support for both currencies. On the data front, we will see 1Q GDP releases in the Czech Republic and the April CPI print in Poland, which will be the first to show the further effects of the Ukrainian conflict on inflation in the region.

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