FX Daily: Conditions continue to settle ahead of US data

Financial markets are reopening with a mildly positive mindset after a long weekend in many countries. Measures of emergency dollar borrowing are starting to slow and equities appear on a slightly steadier footing. Today's session will focus on US small business optimism ahead of important US releases later in the week. Dollar to stay mildly offered

USD: Cautious optimism prevails

A sense of cautious optimism remains in financial markets as various measures of financial stress modestly ease back after last month's US banking crisis. Evidence for those of a bullish mindset is the small drop in emergency dollar demand through the Fed's discount window and the fact that the Federal Home Loan Bank system has had to issue much less debt in support of US regional lenders. It remains a very tricky trading environment, however, given many experienced commentators are refusing to dismiss last month's events as a one-off and instead prefer to see bank failures as a harbinger of forthcoming stress in the global financial system.

What will be key to the bullish story is the Fed's ability to cut rates later this year to offset the impending credit crunch. This week's events calendar will shed some light on that. Tomorrow will probably be the most interesting day of the week, where the US March CPI should make the case for a 25bp Fed hike on 3 May (18bp currently priced), while the FOMC minutes will reveal some of the Fed's thinking behind March's 25bp hike in the midst of a banking crisis. Any signs that the Fed is very close to a peak in rates – and that it will have the ability to cut rates if need be – would be seen as risk-positive and dollar negative.

For today, the focus will be on the NFIB small optimism index. Any sharp fall in optimism and especially a further drop in pricing intentions could soften the dollar slightly. DXY can probably drift back to the 102.00 area.

Chris Turner

EUR: 1.10 is holding EUR/USD for now

Recent public holidays may well have played a factor in keeping EUR/USD below 1.10 and the pair only saw a muted reaction to what was a good US March NFP release last Friday. Potentially, EUR/USD could have come a lot lower on this after it firmed up expectations for a 25bp Fed hike on 3 May. Instead, EUR/USD is trading in a narrow range and waiting for its next major input, probably from the western side of the Atlantic.

More locally, the eurozone today sees the April Sentix Investor Confidence survey and February retail sales. The week will also see several ECB speakers – especially at the Spring IMF meetings in Washington. Here the market currently prices a 25bp ECB hike in May (we agree) but only 12bp of further tightening in June. Our team thinks we could see a further 25bp tightening in June too – leaving the ECB deposit rate at 3.50% – which would then mark the plateau and unchanged rates into the second half of 2024.

EUR/USD can edge back up to the 1.0930/50 area today assuming that equities stay mildly bid and the US NFIB data emerges on the soft side.

Chris Turner

GBP: BoE Governor Bailey in Washington this week

Markets currently price a further 25-50bp of Bank of England (BoE) tightening this summer. We think the risk of a pause at the current 4.25% Bank Rate is under-priced. Shedding light on this topic will be UK data and speeches from key BoE officials this week. On the former, Thursday sees the UK February monthly GDP and also the BoE credit conditions survey. Tomorrow sees the BoE Governor speaking on the subject of the 'The shifting risk landscape', where he perhaps can shed some light on the balance between getting inflation under control and the risk of over-tightening.

EUR/GBP has just about been keeping its head above the 0.8750 support level. We favour a return to the 0.89 area. And our base case is that GBP/USD may struggle to sustain a break above 1.25 this quarter – whilst the Fed is still in the last stages of tightening.

Chris Turner

CEE: Rally is slowing down

Today's calendar is basically empty in the region, but things will get more interesting in the coming days. March inflation in Hungary will be released tomorrow. We expect a drop from 25.4% to 24.8% year-on-year, slightly below market expectations. Hungary will also release state budget data, which has come under pressure in the first two months, and Czech labour market data. On

Thursday, we will see March inflation in the Czech Republic. We expect a drop from 16.7% to 14.8% YoY, slightly below market expectations. And March inflation will also be released in Romania where we also expect a drop from 15.5% to 14.2% YoY, slightly below market expectations. On Friday, the inflation saga will end with final numbers in Poland, which should confirm the 16.2% posted earlier.

We will also have two interesting sovereign rating reviews on Friday in Romania and the Czech Republic. In Romania, S&P maintains BBB- with a stable outlook. We do not expect any changes, but at the same time we see a 25% chance of an upgrade in the outlook to positive. In the Czech Republic, S&P holds AA- with a stable outlook and we do not expect any changes here either. However, Fitch and Moody's has already downgraded the outlook to negative in the past year and the risk is thus down.

Positive conditions still prevail in the CEE FX market, however, we expect the current rally to start running out of steam. EUR/USD is struggling to reach 1.10 and we don't see much room for further risk premium reduction in the EM space. Moreover, inflation numbers this week may return dovish expectations to the region, which should put the brakes on the current FX rally. The Czech koruna and the Hungarian forint remain our favourites, but the room for appreciation is getting thinner. For now, we see a gravity point at 23.30 EUR/CZK and 375 EUR/HUF.

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