

FX Daily: CPI time

Today sees one of the biggest economic releases of the month – US CPI data. Consensus expects the core rate to rise 0.3% MoM, which would mark the fifth consecutive month of being above the Fed's 2% yearly target. A firm CPI print is very much expected, however. Larger FX moves and a softer dollar would materialise on a 0.2% MoM release for core prices



Our US economist suggests that it has been the housing component (40% weighting in core CPI) which has been proving sticky recently

➔ USD: Will CPI continue to thwart Fed dovishness?

US CPI data is the biggest piece of market-moving data each month. Perhaps that is no surprise given the pandemic, the Ukraine war inflation shock and, thankfully, strong signs of disinflation which emerged globally through the second half of 2023.

For the Federal Reserve, sticky inflation has proved a thorn in its side. Chair Jerome Powell sounds like he would love for the Fed to cut rates and fulfil the dual mandate of 2% inflation and maximum employment. The bumpy road to disinflation risks keeping US monetary policy restrictive for longer – and increases the risk of higher unemployment in 2025.

Delving into today's CPI data, our US economist James Knightley notes that it has been the housing component (40% weighting in core CPI) which has been proving sticky. Here, the issue of Owners' Equivalent Rent (OER) and how to measure it has been playing a role. A January re-

weighting within the OER basket means that few can say with confidence when the OER may play catch-up with softer private sector surveys of rent, which explains the consensus looking for 0.3% month-on-month for the core figure.

We do, however, see an asymmetric reaction from the dollar to today's CPI data. A firm number has been expected and is consistent with the sticky inflation and firm activity data witnessed so far this year. We would expect a bigger dollar sell-off on, say, core CPI at 0.2% month-on-month than we would a dollar rally on a 0.3% or even 0.4% release. This because the Fed has said that it wants to cut rates probably three times, if only the data would allow it.

Of late, the dollar has been underperforming the higher US yield curve. A softer CPI figure would set the dollar bears free and could see DXY correct back to the 103.20/40 area.

Elsewhere, in New Zealand, the RBNZ kept rates on hold as expected. Policymakers expressed the need for tight policy a little bit longer to ensure inflation is heading to its targeted range, but also mentioned concerns about "more unemployment and financial stress" and slow inflation faster than expected. NZD is trading 1.647 against USD, slightly stronger since the release.

Chris Turner

➔ EUR: Room to correct even without CPI and ECB shocks

The two-year EUR:USD spread has shrunk modestly since Monday, while remaining significantly wide at -143bp. We have argued that EUR/USD rallies looked hardly sustainable given the backdrop of a hawkish repricing of Fed rate expectations, and there is still room for EUR/USD to fall in the near term – even if the US CPI and ECB announcement match market expectations.

We are reading more about the risks of EUR/USD sliding back to parity. While acknowledging there is a non-negligible chance of Fed easing being delayed, such a big slump would probably require the European Central Bank to move in total independence as the Fed stays put for a few more quarters. The ECB cutting a few months before the Fed should be sufficient in taking the pair back to parity on its own, as an eventual easing cycle in the US should have an asymmetrically negative impact on the USD. If anything, risks on the geopolitical side – potentially as a consequence of US elections – would justify greater pessimism on the euro.

Francesco Pesole

⬇️ CAD: A BoC cut is not that absurd

The Bank of Canada announces monetary policy today, and the consensus appears to be that it will continue moving to the dovish side of the spectrum. As discussed in [our preview](#), we agree with this view. The economic picture has continued to move in favour of policy easing since the 6 March meeting, with headline and core CPI decelerating more than expected, jobs surprisingly contracting and unemployment rising to 6.1% in March.

There are lingering concerns on wage growth (still at 5.0%) and the better-than-expected growth in January, but at the same time, the BoC's Business Outlook continued to show the tight grip of high rates on the economy and sluggish expectations for future sales.

We think the BoC will keep rates on hold today but drop hints that it is preparing to cut rates at the coming meetings. That should reinforce expectations (and our base case) for a June rate cut –

which is around 75% factored into the CAD curve. There are also 4bp of easing priced in for this meeting, and we must admit that a cut today would not be that absurd. The progress on inflation in Canada is clear, and there is growing domestic pressure to start cutting. If Fed rate expectations hadn't faced a hawkish repricing of late, markets would probably be pricing in more than 4bp for the BoC today.

Today's meeting can pave the way for a wider USD-CAD short-term rate spread, which should provide a floor to USD/CAD. That is, of course, unless US CPI figures surprise on the downside. We think USD/CAD can consolidate above 1.3600 in the near term.

Francesco Pesole

📉 CZK: Inflation is heading below the central bank's target

This morning, we will see the inflation print in the Czech Republic for March. We expect a drop from 2.0% to 1.9% year-on-year, slightly below market expectations and below the central bank's target. However, we see clear downside risks here. The downward movement is mainly driven by food and energy prices, but also some service sectors that have been a concern for the central bank in recent months. Therefore, we also expect core inflation to fall from 2.8% to 2.5% YoY. It's energy prices (which can be hard to capture in CPI) that we think may surprise to the downside today. In any case, both headline and core inflation will be well below the central bank's forecast (2.9% and 3.3%), which is already diverging from the January print. While inflation is likely to head further below the central bank's target in the coming months, for now we believe the Czech National Bank will want to stay on the safe side and keep the 50bp pace per meeting with a 3.50% rate at the end of this year in our forecast.

However, from a market perspective, we think today's inflation number will bring back the discussion of a possible 75bp rate cut, the same as before the March meeting. Financial markets at the moment are probably halfway between 50bp and 75bp priced in – however, the longer horizon in our view has room to price in significantly more rate cuts and undermine the CZK. On the other hand, EUR/CZK is already higher than fundamentals would suggest in our view and we therefore do not expect a significant move today, rather a stabilisation at currently weaker CZK levels.

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