FX Daily: Data to regain centrality

Markets are pricing out some geopolitical risk and sentiment is looking supported at the start of this week. In the coming days, data should regain its role as the main market driver; US GDP and PCE may come in relatively strong and prevent dollar momentum from softening much. We'll see whether Japanese authorities draw a line in the sand at 155.0 in USD/JPY

USD: US GDP and PCE figures this week

Weekend news has helped ease market-perceived geopolitical risk, and sentiment is generally supported across asset classes as the week starts. All interested parties appear to have chosen the path of downplaying the size and consequences of Friday's Israeli strikes in Iran. Bent trading below $90/bbl signals that fears of a broader conflict in the region have abated. Another important piece of news for geopolitics was the approval by the US House of the much-debated $95 aid package for Ukraine, Israel and Taiwan. The implications for risk sentiment aren't as clear here, as the latest developments in the Russia-Ukraine conflict have not seemed to drive market moves recently.

A less volatile geopolitical scene also paves the way for a return of data as the main market driver. There are two major releases in the US this week. GDP growth is widely expected to have slowed in the first quarter – and when the advanced numbers are published on Thursday, we expect a 2.6% quarter-on-quarter annualised print, slightly above the 2.5% consensus. As for March's core PCE deflator out on Friday, we are calling for a consensus 0.3% month-on-month. That is lower than core CPI (0.4%), where housing has a greater weight, but still too high for the Federal Reserve to revamp the narrative of an imminent rate cut. Remember that PCE is the Fed's favourite measure of inflation.

We have entered the blackout period for policy comments ahead of the 2 May FOMC meeting, but it is now largely expected that the Fed will need to scale back some of its dovish narrative as inflation and jobs both surprised on the upside. The latest comments from most members (including Chair Jerome Powell) have stressed patience, and market expectations should converge towards a return of a simpler data-dependent approach as opposed to the moderately dovish quasi-guidance we had seen until April.

The dollar may see a further softening in its momentum due to a calmer risk environment, but we see data reinforcing the notion of a resilient US economy with lingering inflation issues, so the key underlying arguments for a stronger dollar should not be dented. Risks of DXY moving to 107.0 remain fairly high.

Francesco Pesole

EUR: PMIs and ECB speakers in focus

Abating concerns on Middle East tensions are positive for the pro-cyclical euro, although that also lowers the chances that higher oil prices will force a delay of the European Central Bank's cutting cycle. Market pricing for total 2024 easing is firming up at 75bp, which is also our call.

Substantial data or market events may be needed to force a major repricing of ECB rate expectations at this point, and this week's activity surveys in the eurozone may not really move the needle. PMIs are out on Wednesday and are expected to improve marginally despite the manufacturing gauge continuing to act as a major drag. On Thursday, all eyes will be on the IFO reads for Germany, where consensus is also looking for a modest increase. On Friday, the ECB will publish the results of CPI inflation expectation surveys for March, where the three-year gauge should inch lower and endorse the ECB's dovish shift.

Today, ECB President Christine Lagarde will give a lecture at Yale University, and may not touch upon current monetary policy issues. Still, the week is full of scheduled speeches by ECB members from all sides of the dovish/hawkish spectrum, from the dovish Fabio Panetta and Mario Centeno to the hawkish Joachim Nagel and Isabel Schnabel. We'll be interested to see whether latest geopolitical developments will translate into some resistance to easing from the hawks.

EUR/USD could stay on a holding pattern until key US data start to flow in from Thursday. There is probably room for a small rebound, but monetary policy divergence continues to point to downside risks, and a re-test of 1.0600 could already be triggered later this week if US data comes in strong.

Francesco Pesole

GBP: Ramsden moves the market

Sterling markets moved on Friday after the Bank of England's deputy governor, Dave Ramsden, sounded less concerned about price pressures and suggested that there were indications of UK inflation converging to that of the eurozone. Crucially, he added that the Bank will be "responsive" as evidence on inflation accumulates.

Markets revamped some of their BoE rate cuts bet on Friday after strong wages and inflation had triggered a hawkish repricing. Expectations are now for 53bp of easing this year, with a first 25bp cut fully priced in for August.

The only market-moving data release in the UK this week is PMIs on Tuesday. Remember that UK activity surveys have generally exceeded expectations in the past six months, but also that March saw the first month-on-month decline in composite PMI. While still above the 50.0 level (in expansionary territory), back to back MoM drops could help heavier speculation on rate cuts.

We feel the rebound in EUR/GBP might have happened a bit too early, and still see risks below 0.8600 in the short term as markets hold greater dovish conviction on the ECB than the BoE. Ultimately, beyond the short run, the upside potential for EUR/GBP should still be unlocked by the BoE cutting more aggressively than market currently prices in, in our view.

Francesco Pesole

JPY: A 155.0 dilemma for Japan ahead of BoJ

The Bank of Japan announces monetary policy on Friday and is widely expected to keep rates unchanged after March's 10bp hike. The market's focus should therefore be on the BoJ's quarterly forecast report. Our economics team expects the inflation forecast to be revised upwards, considering the increased inflation in the first quarter, wage growth that exceeded expectations and a weaker yen. PMIs tomorrow and Tokyo's CPI on Friday are two important releases.

All in all, we don't think the BoJ will push back (implicitly or explicitly) against the current pricing on further hikes. Hawkish bets are – incidentally – not too aggressive, with a total of 21bp priced in by year-end. Instead, we think there is plenty of room for rate hike expectations to rise as the year progresses, and our economists currently expect a 15bp hike in the third quarter and a 25bp hike in the fourth quarter.

In the short run, however, the yen remains in a precarious situation. A de-escalation in the Middle East means safe-haven unwinding, leaving JPY under pressure from the structurally higher Treasury yields. We are well into intervention territory, and we'll see whether Japanese officials draw a line in the sand at 155.0.

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