FX Daily: Dollar at the crossroads

FX markets are relatively quiet as traders focus on slowing inflation in Europe, poor EV sales from Tesla, and steady US data. The next big story will be whether investors cut their expectations for 2024 Fed rate cuts to just two from three and the dollar needs another leg higher. Precious metals suggest not, but this week's US jobs data will have a big say

EUR: European disinflation builds the case for rate cuts

Germany followed other euro area national releases and surprised on the downside with its March inflation release. That sets up the risk of a sub-consensus (2.5% year-on-year) eurozone release at 11CET today. The soft price data will keep investors fully pricing the first European Central Bank cut in June - as is the ING house view. As discussed yesterday, rate spreads remain very much in favour of the dollar at the moment and if EUR/USD is to turn higher it will have to be driven by softer US activity/price data and a re-assessment of Fed policy.

EUR/USD managed to find some support ahead of 1.0700 yesterday but needs to close above 1.0800 to inject some stability into an otherwise bearish near-term trend. For reference, it seems that investors are not particularly convinced that the next significant leg in EUR/USD is lower, where the three-month risk reversal - the price for a euro put option over an equivalent euro call option - has not widened beyond the 0.5% area.

Chris Turner

USD: ADP and ISM Services in focus today

In yesterday's update, we pointed to the importance of the JOLTS data release and what it meant for US wage pressure. As our US economist, James Knightley, points out in his review, signs of cooling in the US labour market can best be described as 'subtle'. So there were further signals of the US labour market moving into better balance, but it is slow progress. The release saw US two-year yields edge three to four bps lower, but that still left the market looking for just 68bp of Fed easing this year - i.e. less than the three rate cuts in the median Fed dot plot. The near-term trend in the dollar will therefore be driven by whether the data narrows Fed 2024 pricing to just two rate cuts - or whether some softness in activity or prices re-inserts 75bp as the minimum number of rate cuts expected this year.

In terms of that data calendar and ahead of Friday's nonfarm jobs release, today sees the widely discredited ADP jobs release (consensus 150k) and then the ISM Services release where investors will be focusing on overall confidence, prices paid and the employment component. Consensus is looking for modest improvements across the board here, which if delivered could prove mildly dollar-supportive.

Yet before investors position for the next leg higher in the dollar, there are a few amber warning signals. March US vehicle sales came in on the soft side yesterday and point to a soft retail sales figure for March. And today the share prices of electric vehicle makers are under pressure around the world after a big miss for Tesla deliveries in the first quarter. We also note that precious metals (gold and silver) continue to tear higher. This normally is associated with a weaker dollar, although currently may be more of a function of central bank buying - touching on the de-dollarisation theme.

We have certainly not abandoned our call for a weaker dollar trend starting this quarter, but let's see how the US data plays out over the coming weeks. For DXY, maybe it is that 105 is proving some decent psychological resistance, but a close below 104.40 is required to slow/reverse what is undoubtedly a bullish near-term trend for the dollar.

Chris Turner

CEE: March inflation in Turkey and recalibration with core rates

Today we have only Turkey's March inflation in the CEE calendar. We expect an increase from 67.1% to 70.1% YoY, above market expectations. Deteriorating expectations on the back of inflation in the previous two months and an acceleration in exchange rate depreciation in March are likely to be key reasons for another significant increase in prices last month. Going forward, the question remains as to whether or not the Central Bank of Turkey's sharp response of an unexpected and significant rate hike, a large set of macro-prudential measures and liquidity tightening are enough to return the inflation path to the CBT's forecast range, and this will be closely followed by the market.

On the FX side, the market was catching up with the sell-off in core rates yesterday as expected, which did not look so negative for CEE FX at the end of the day. Despite market rates rising, the interest rate differential did not change much. However, risk-off sentiment and a stronger US dollar will still be a problem for any recovery here. We are thus positive on the Czech koruna only from this point, where levels have reached a sufficiently weak point, while it is the only country with a rising interest rate differential in recent days implying levels more around 25.20 EUR/CZK. Poland's zloty avoided the depreciation we expected after the downside inflation surprise on Friday given that the sell-off in core rates offset the rally in PLN rates. Thus, we see EUR/PLN around 4.290 fair for now while expecting some support for PLN from the National Bank of Poland later this week. On the other hand, Hungary's forint eased a little yesterday but we still see more to come, heading above 395 EUR/HUF.

Frantisek Taborsky

Latam: Wide variations

Latam FX is witnessing some wide variation at the moment - most evident in the BRL/MXN cross rate falling to its lowest level since 2003. Driving that divergence is the market's love affair with the Mexican peso - the preferred carry trade target - and most recently some independent weakness in the Brazilian real. Last month it was Brazilian President Luiz Lula's intervention in Petrobras's desire to issue a special dividend that weighed on the real. This month, there is an even more esoteric story of a maturity of $3.7bn worth of NTN-A Treasury bonds which is leading to pressure on the real. In fact, Brazil's central bank intervened to support the real yesterday, auctioning off US$1bn of FX swaps and adding to its large derivative position short dollars. We cannot see this BRL/MXN trend reversing anytime soon.

Elsewhere, Chile's central bank slowed the pace of its easing cycle to 75bp yesterday. Clearly, USD/CLP close to 1000 questioned whether it could continue slashing rates at the same pace. We continue to see the peso under pressure until the US rate/dollar trend turns lower.

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