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FX

FX Daily: Bearish dollar momentum may not last

We suspect that the Fed pricing after the US CPI is already embedding some optimism on core PCE (released 31 May) and jobs figures in early June. With no key data before that PCE print, FX volatility may drop again, and the dollar may stabilise or recover some ground in the next couple of weeks. A move to 1.10 in EUR/USD looks premature



➔ USD: Dollar could stabilise in next couple of weeks

Markets have given a greater weight to the encouraging news coming from two days of inflation figures, which has caused the dollar to almost entirely erase the gains after the CPI disappointment in mid-April. Yesterday, a core CPI print at 0.3% month-on-month marked the first slowdown in six months, while retail sales stagnated in April, adding to speculation of abating US economic momentum. For now, the fact that inflation remains too hot for the Fed to consider cutting rates does not seem to bother market bulls too much.

Two FOMC members spoke after CPI yesterday. Neel Kashkari (a hawk) reiterated his concerns that policy might not be tight enough and that rates will likely be held higher for longer, and Austan Goolsbee (often dovish leaning) also stressed that there is more work to do on disinflation. Markets have pushed their expectations back to two rate cuts this year for the first

time in a month. While our view remains more dovish than consensus (three cuts in 2024, from September), current pricing seems to be embedding some optimism that core PCE later this year and jobs figures in early June will also endorse a more dovish narrative.

Our preferred call at this stage is not for a continuation of a dollar decline until the end of May, but instead a period of quiet trading with little sense of direction and low volatility. That's mainly because hard data is needed to move the needle substantially on Fed pricing, and the next key release – core PCE – is only on 31 May. If we are right, expect carry trades to be the go-to strategy in the next couple of weeks, and the rally in the ultra low-yielding JPY to prove hardly sustainable. Disappointing Japanese growth figures overnight are already contributing to cooling momentum for the yen. The high-yielding dollar does not need to fall much further in such a quiet environment, and we favour a stabilisation in the 104/105 area (DXY).

Today's US calendar includes jobless claims (which moved the market last week), April's housing starts and the Philadelphia Fed Business Outlook index, which is expected to ease back after a strong read in April. A number of Fed speakers are scheduled for today, including hawk Raphael Bostic and the more neutral Loretta Mester and Thomas Barkin. Overnight, retail sales and industrial production out of China can set the market tone into the weekend.

Francesco Pesole

➔ **EUR: 1.10 looks premature**

EUR/USD has rallied around 1% this week thanks to the dollar drop, although the euro is lagging other pro-cyclical currencies in the G10 (excluding the US data-dependent CAD). This is hardly surprising, as the euro has the lowest three-month correlation with two-year USD swap rates – which had previously shielded it from the major repricing higher in Fed expectations.

The 1.0900 level should not be a very strong resistance if US data – for example, jobless claims today – adds pressure on the dollar. However, a move to the 1.1000 benchmark levels seems premature given the still sticky inflation picture in the US. We are less concerned on the European Central Bank generating much pressure on the euro leg. A June cut is fully priced in and a near guarantee at this stage, but latest eurozone data suggests data-dependency will be a more likely message from ECB President Christine Lagarde as opposed to dovish guidance.

Today, the eurozone calendar includes final April CPI figures and speeches by Luis de Guindos (who presents the ECB financial stability review), Labio Panetta, Pablo Hernández de Cos, Mario Centeno, François Villeroy and Joachim Nagel. It remains unlikely that policy comments can trigger major moves in the very sticky ECB pricing.

Elsewhere in Europe, Norway posted 0.2% quarter-on-quarter growth for the first quarter this morning, in line with expectations. NOK has had a strong start of the week with its peer SEK, although the Norwegian currency appears in a relatively stronger position given the Riksbank's

recent rate cut and risks of further easing. We'll hear from the Riksbank's Deputy Governor Martin Floden this morning, and from Governor Erik Thedeen tomorrow.

Francesco Pesole

➔ **AUD: Unemployment rises in Australia**

Australia's employment grew 38.5k in April, as per data [released overnight](#). However, the increase was entirely driven by part-time hiring, and the unemployment rate surprisingly rose to 4.1%, which has prompted a moderate negative reaction in AUD.

We have just published an [economic and market update on Australia](#), with parallels to the US economy. Our view is that the Reserve Bank of Australia is unlikely to cut rates more than once this year even if the Fed delivers 75bp of easing, which bodes well for further AUD gains should lower USD rates allow it. We also continue to see a marginal risk of the RBA having to hike again as inflation risks look skewed to the upside in the near term.

AUD/USD may see the best window for a substantial rally this summer, when we expect US data to soften, although the risks to Chinese sentiment from a potential Trump re-election may trigger a more cautious stance on the Antipodeans from September to November (and beyond, if Trump wins). A retest of the 0.6850 December high is a possibility for the coming months.

Francesco Pesole

⬆️ **CEE: Weaker US dollar unlocking another leg of rally in region**

Today's calendar in the CEE region is basically empty. In Poland, the central bank will publish an estimate of core inflation. The final numbers for April were confirmed yesterday at 2.4% YoY and we believe this is the last low print before rising again in the coming months, with 5.5% at the end of this year in our forecast. Core inflation should show 4.0% YoY from March's 4.6%, in our view.

In FX, markets will have to process yesterday's US inflation data. A weaker US dollar should be positive for CEE FX. On the other hand, we can expect a rally in local rates which should dampen the positive effect. However, FX has not followed rates much in the last three weeks and, at least for today, the net effect should be stronger FX across the region. We remain most positive on PLN, which could benefit the most from a weaker USD in the region and test the new lows below 4.260 EUR/PLN.

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