FX Daily: Dollar grinding higher

Another quiet trading session saw the dollar grind higher yesterday. The highlight of today's session will be the release of the Fed minutes. It seems too early for the Fed to countenance easing - suggesting the dollar will hold recent gains. The market approves of the start of monetary policy normalisation in Hungary. The Czech koruna could see a rebound

USD: FOMC minutes in focus

Both the dollar and US yields continue to claw back the losses made in the immediate aftermath of the US regional banking crisis in March. As noted yesterday, the debt ceiling threat seems to be posing an ephemeral risk to markets and instead the core focus is on US activity and prices holding up - questioning whether the Fed really needs to deliver any rate cuts later this year. Shedding light on this debate will be tonight's release of the FOMC minutes. Like many central bankers around the world, the Fed's biggest challenge is to get inflation under control. As such there may be little to gain from emphasising a pause, let alone the prospect of future easing.

And with EMFX on the back foot - e.g. USD/CNH trading up to 7.06 - we think this dollar correction could have a little further to run. We would be bracing for dollar strength in the aftermath of the FOMC minutes.

Chris Turner

EUR: Softer trends

We are seeing the euro a little softer across the board this week. Yesterday's release saw May flash PMIs on the soft side, but inflation in the service sector did stay resilient - which will be troubling for the ECB. As above we think this dollar correction may have a little further to run and EUR/USD could trade down to the 1.0700 area if the Fed fails to play down the risk of future rate hikes.

In New Zealand, the RBNZ surprised markets with a dovish 25bp hike. The recent spending boost by the government, an upward revision in growth forecasts and rising migration had led many analysts – including us – to expect that the RBNZ would have signalled more hikes in its new rate projections. Instead, the RBNZ deemed the impact of rising net migration on inflation as uncertain, with that of fresh government spending likely to be spread over more than one year and focused on the evidence of a slowing economy, the impact of already restrictive monetary policy, a struggling housing market and lower-than-expected CPI figures. The decision to hike by 25bp today was a close one (five to two vote split), and rate projections signal this is indeed the peak of the tightening cycle in New Zealand. NZD/USD fell sharply after the announcement, trading below 0.6200, and may test 0.6100 by the end of the week if USD momentum remains strong.

Chris Turner

HUF: Markets allow further normalisation of monetary policy

The National Bank of Hungary cut the effective rate by 100bp to 17%, moving into a period of effective normalisation. However, this normalisation remains conditional on the persistence of market stability. The central bank insists on a cautious and gradual approach. The Hungarian forint is still unsurprisingly on the weaker side after the NBH meeting yesterday, but close to earlier levels - suggesting that the market is satisfied with the pace of monetary policy normalisation. This EUR/HUF level will allow the central bank to continue in this direction.

We continue to see a working framework for the coming weeks in the 370-380 EUR/HUF range and believe that the market will use current weaker levels as a new entry point to build positions in the forint to benefit from still very attractive carry. Moreover, given rather pessimistic market expectations, we see potential upside risks on the EU funds side of the story. Overall, we thus expect EUR/HUF to move rather below 375 EUR/HUF. Any positive surprises may even see a return to 370 but we see a more significant move below this level only later this year.

Frantisek Taborsky

CZK: Rates indicate a stronger koruna but the US dollar is key

The Czech koruna has lost much of this year's gains in recent days and has become the main underperformer in the region after the Polish zloty's rally. After the downside inflation surprise in April, the interest rate differential has fallen and the koruna is showing by far the highest beta against the US dollar. This is negatively impacting the entire EM space at the moment. However, the last few days have seen payment flows in the rates market, following core rates and hawkish CNB views. Thus, a higher interest rate differential again indicates a return of the koruna to below 23.60 EUR/CZK. EUR/USD will be crucial and may keep the koruna at weaker levels for a while longer. Today we'll see consumer confidence data that could add to positive market sentiment, and later today we'll likely hear more hawkish comments from CNB's Tomas Holub.

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