

## FX Daily: Dollar's rate advantage is narrowing

As key central bank meetings draw closer, markets appear to favour European currencies to the detriment of the dollar, whose rate advantage is being eroded. The two-year EUR-USD swap rate differential is now the narrowest since August 2020, adding to EUR/USD support. Elsewhere, we expect a 700bp cut by the National Bank of Hungary today



### 📉 USD: Soft momentum

The week has started with the market leaning again in favour of European currencies and the dollar losing some ground. The price action in short-dated bonds showed a reinforcement of European hawkish bets while the whole US Treasury yield curve inched lower.

Data will be back in focus today in the US, with the Conference Board's Consumer Confidence Index expected to have flattened in April and the Richmond Fed Manufacturing Index possibly inching lower. Some housing data will also be released and should underpin the notion of ongoing pain in the real estate sector.

While a 25bp hike next week by the Fed does not look under discussion, Fed rate expectations have remained rather un-anchored and volatile when it comes to future policy moves. This continues to leave ample room for speculation about Fed Chair Jerome Powell's tone in terms of future guidance. While data will clearly play a role, recent developments in the US banking sphere are creeping back onto investors' radars. First Republic Bank reported a larger-than-expected drop in deposits in its quarterly results, sparking a new round of heavy selling in the stock after a prolonged period of calm.

This is probably the key thread to follow today: should there be fresh instability in US banking stocks, dovish Fed bets may gather more momentum, and despite its safe-haven status, the dollar could stay on the back foot to the benefit of European currencies backed by hawkish central banks and without an excessively high-beta to sentiment – like CHF, EUR, GBP.

*Francesco Pesole*

## EUR: Narrowing spreads

The two-year EUR-USD swap rate differential is now at -65bp, the narrowest since August 2020. The 2020 high is -53bp. We would then need to go back to 2014 (when EUR/USD was trading at 1.20-1.30) to see levels beyond the -50bp mark. While the correlation between short-term rates and the currency pair has been rather unstable and weak of late, this is indeed a factor contributing to a bullish narrative for EUR/USD.

As discussed above, new jitters in the US banking story, as quarterly earnings are released, may hit Fed rate expectations before they are channelled through more structurally defensive trades in FX. EUR/USD could break the 1.1075 14-April highs and find limited technical resistance beyond. Global conditions don't necessarily point to a higher EUR/USD, but the ongoing momentum in the FX market seems to bring markets closer to European currencies and away from the dollar.

Sweden's krona has been stabilising ahead of tomorrow's Riksbank meeting. Our call is a hawkish 50bp rate hike ([full preview here](#)), and the more favourable environment for European currencies could be positive for the krona, which would be a good outcome for the central bank. But short-term woes remain outside the bank's control: for example, some Swedish lenders' earnings are due this week and may show the effect of the troubled real estate sector to which Swedish banks are highly exposed.

*Francesco Pesole*

## GBP: No domestic drivers

It's going to be a very quiet week data-wise in the UK, and the market is fully pricing a 25bp rate hike by the Bank of England in two weeks. We still think that markets are over-estimating the amount of further tightening (71bp in total, including next week's hike, before reaching the peak), but unless there is a clear push-back by the BoE at the policy meeting, the pound may not lose its solid momentum just yet.

We think that EUR/GBP should trade at 0.90 in the second half of the year, but may hover around 0.8850 for now, while some USD softness may trigger another break above recent highs (1.2543) for cable.

*Francesco Pesole*

## 📌 HUF: Central bank starts monetary policy normalisation

Today we have a [meeting of the National Bank of Hungary \(NBH\)](#), which last week indicated that it is time to start normalising monetary policy. We think the NBH will make a bold move in cutting the top end of the rate corridor by 700bp to match the effective rate at 18%. EUR/HUF stayed below 380 after last week's announcements, and returned to 375 yesterday following news of a consensus reached with the European Commission, indicating progress in the negotiations on Hungary's access to EU money. Altogether, we think this frees the NBH's hands to make a bold move. It is hard to read market expectations for a cut in the overnight deposit rate given that it is not an effective rate. However, we are more on the dovish side of the spectrum.

Of course, the NBH's communication will be key for the forint, but it can be assumed that it will signal to the market in any case that monetary policy normalisation has begun. We should still keep in mind that the market is probably strongly long HUF despite the EUR/HUF move up last week. Thus, the NBH's dovish communication could easily be a trigger for further upward movement. However, as a base case scenario, we see the NBH in control of the situation, supported by EU headlines, and expect only a modest EUR/HUF move up, not exceeding 380.

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