

FX Daily: Emerging market FX misfires

This month's hawkish re-appraisal of the Fed's cycle is strengthening the dollar across the board. Some of the more vulnerable EM currencies are hitting new lows. The subdued Chinese growth story certainly is not helping either. For today, it's all about the 1430CET release of the US core PCE deflator. Unless we see a soft figure, the dollar stays bid



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➔ USD: Only a soft core PCE sees the dollar rally stall

The dollar continues well bid and is knocking on the door of some of the key technical levels we identified in [yesterday's update](#). In recent client meetings, we have been making the case that a cyclical dollar bear trend has yet to really begin and will not start until the inverted US yield curve breaks sharply into a bullish steepening. That is our forecast for the third quarter.

For the time being then, the dollar is staying strong across the board. USD/JPY has popped its head above the 140 level prompting comments from the Japanese Finance Minister that he is watching FX markets closely. This is typically a warm-up for intervention. Last September, however, the Bank of Japan did not intervene to sell USD/JPY until the 145 area – which is probably a useful benchmark for today.

The strong dollar – and weak Chinese growth – are also posing problems for the currencies of some of the emerging market economies. South Africa's rand hit a new low against the dollar yesterday despite the South African Reserve Bank (SARB) delivering an expected 50bp rate hike. The governor

of the SARB may have been too candid in his comments that he expects the rand to weaken, although he has been saying that for some time. Equally, the normally solid Israeli shekel has traded a lot weaker than we had forecast in our latest [FX talking](#), where this week's successful passage of the budget has seemingly given the Netanyahu government license to push ahead with controversial judicial reforms. Please listen to our latest [Think Aloud podcast](#) for more on these topics.

Back to the short term, the mood music is slightly better on the US debt ceiling – but next week will be crucial. (Read more about the details of default in Padhraic Garvey's opinion piece [here](#)). And today is all about the April US core PCE deflator. Expectations are for another firm 0.3% month-on-month / 4.6% year-on-year figure which will feed into the narrative that core inflation is not falling as quickly as the Fed would like. Unless this surprises on the downside, expect the dollar to stay bid. A DXY close above the 104.00/104.20 area opens up a run at the 105.88 high next week.

Chris Turner

➔ EUR: Some interest in the upside

There were reports in the market yesterday of some upside interest in EUR/USD going through the FX options market. We can see why. 1.0700 is a decent support area for EUR/USD and we do see the outside risk of a break to 1.0500. However, the eurozone terms of trade story is so much better than it was last summer and that is why our medium-term models identify EUR/USD as very under-valued. Our view is that 1.05/1.07 proves the base for a push towards 1.15 in the third quarter, once clearer signs of US disinflation and slowing activity become a lot clearer.

For today, we should be hearing from ECB chief economist Philip Lane. Yesterday the head of the Dutch central bank and arch hawk Klaas Knot said he favoured rate hikes in June and July, while keeping the option open for September. That is roughly in line with market expectations too. Overall, expect EUR/USD to stay soft near 1.0700/0720 and perhaps take a decisive turn on the 1430CET release of the US inflation data.

Elsewhere, EUR/SEK is continuing to push higher. Riksbank speakers have been reasonably explicit about the growing threat of the commercial real estate sector. We are monitoring Swedish money markets – e.g. the 3m Stibor-OIS spread for any signs of stress (none yet). Were they to emerge, EUR/SEK would probably go through 12.00.

Chris Turner

⬆️ GBP: The case builds for a June hike

This morning has just seen UK April retail sales surprise on the upside. Excluding energy, retail sales came in at +0.8% MoM versus +0.4%MoM expected. This will firm up the case for a 25bp Bank of England hike on 22 June. And it will also delay any adjustment to the very hawkish expectations currently built into money markets, where the Bank Rate is priced up at 5.50% early next year. We have been fighting that pricing all the way, but if we are seeing some kind of 'positive income shock' from unemployment staying low during a recession, then those higher rate expectations may endure.

Today's data make the case for EUR/GBP to retest 0.8650 and for GBP/USD to hold above this 1.2275/2350 band (assuming US inflation data does not surprise on the upside).

Chris Turner

📌 CEE: Stronger US dollar leaves us bearish on the region

Today's calendar in the region has little to offer and the US dollar will continue to be the main driver for CEE FX. In Hungary, labour market data will be released and deputy governor Barnabas Virag is expected to address a conference for the first time since Tuesday's meeting of the National Bank of Hungary, which initiated [monetary policy normalisation](#).

In the Czech Republic, we will see a sovereign rating review from Moody's after the close of trading. The agency lowered the outlook to negative from stable last August due to the deteriorating outlook for fiscal policy and the impact of high energy prices on the economy. We believe it is too late for a downgrade and too early for the agency to take into account the recently-unveiled fiscal package and return the outlook to stable. Thus, we expect no change, but we may see the first comment from the rating agency on the government's new fiscal plans.

In the FX market, we see the CEE region stabilising at slightly stronger levels, and yet a stronger US dollar and declining interest rate differential across the region leaves us rather bearish these days. We see the Polish zloty as the most vulnerable at the moment, and it is the only one to avoid major losses in the region so far. Thus, we see values rather above 4.520 EUR/PLN until we see a reversal in EUR/USD. The Hungarian forint should be the only one to benefit from the local normalisation success story that the market visibly likes. Therefore, we expect the forint to stay in the range of 372-373 EUR/HUF. The Czech koruna is teetering between hawkish and dovish Czech National Bank comments, but given the koruna has lost the most in recent days, we believe it should stay below 23.650 EUR/CZK despite the stronger US dollar.

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