

FX Daily: European divergence check

It's a close call, but we expect the Riksbank to overlook the recent krona weakness and cut by 25bp today. This may be a 'hawkish' hike to reduce the FX fallout, but could add fuel to the European-US monetary divergence and spill over into the broader European currency market. Meanwhile, a weak Japanese yen may continue to help the dollar, too



Erik Thedéen, governor of the Riksbank

📈 USD: Supported despite lack of US data

It's been a quiet start to the week in the currency market, and – [as discussed yesterday](#) – lower FX volatility is fuelling a return to carry trades. One of the most popular FX carry trade – long MXN/JPY – has returned 2% since the weekend, despite the risks of more intervention by Japan to support the yen. JPY is, after all, the currency that has moved the most (-1% vs USD) in the G10 this week, and appeared to be helping the dollar strengthen at a broader level overnight. Along with the pressure from its funding character amid falling cross-market volatility, the short-term speculative bias is still apparently to test Japanese authorities' tolerance for a weaker yen.

On the US side, the only highlight today is mortgage application figures in a generally quiet period data-wise ahead of the 15 May CPI report. The Fedspeak calendar includes speeches by Susan Collins and Lisa Cooks, who both stand in the “neutral” part of the hawk-dove spectrum. Yesterday,

the more hawkish-leaning Neel Kashkari [published a note](#) discussing how tight policy actually is, and suggesting a structurally higher post-pandemic neutral rate. In an interview, he also said another hike cannot be ruled out.

Market pricing for Fed cuts in 2024 has stabilised around 45bp after last week's events (FOMC and payrolls) and has so far been rather unresponsive to post-meeting FOMC members' remarks. The dollar is – for once – not being influenced much by domestic drivers and may face further stabilisation in the coming days. There are some further upside risks for DXY as JPY remains under pressure and a rate cut in Sweden this morning (more in the SEK section below) may soften demand for European currencies.

Francesco Pesole

↓ EUR: Linger uncertainty on post-June ECB plans

Eurozone retail sales, released yesterday, showed a nice pick-up in March, endorsing the recent narrative of an improving economic outlook. This morning, Germany released March [industrial production figures](#), which were slightly better than expected but still down 3.3% year-on-year.

While the current slew of economic releases is not influencing markets, it will help shape the European Central Bank's messaging as policymakers prepare to cut rates in June. The indication from members is that this won't be a rapid, straight-line easing cycle. The unchanged rate cut expectations (75bp by year-end) seem to mirror ongoing conditionality and data dependency moving ahead and look unlikely to be steered significantly in the near term.

Today, we'll hear from Governing Council members Pierre Wunsch and Pablo de Cos, who yesterday reiterated the prospect of a June cut but more uncertain future path. Aside from any spillover from the Riksbank decision this morning, EUR/USD volatility may be capped this week, and the pair should still find decent support around 1.0700.

EUR/GBP appears well supported at the start of this week (back above 0.8600) as the EUR:GBP short-term rate differential rose after the US events last week. That is largely due to the sterling curve being more sensitive to Federal Reserve pricing than to the European Central Bank, which has probably caused some more bearish positioning on GBP ahead of tomorrow's Bank of England announcement ([here is our preview](#)). We do not expect the BoE to trigger much more GBP weakness tomorrow.

Francesco Pesole

↓ SEK: We expect a hawkish cut by the Riksbank

We expect the Riksbank to cut rates by 25bp this morning. As discussed in our [meeting preview](#), the currency picture remains quite concerning for Swedish policymakers, and today's decision remains a close call, but recent communication has suggested most of the five-person Executive Board is now leaning towards a move in May.

Markets are pricing in 17bp worth of easing today, and 57bp in total by the September meeting, meaning that failing to curb dovish bets can lead to SEK facing substantial pressure after a rate cut today. The explicit discomfort with an inflationary weak currency means – in our view – that Governor Erik Thedeen will do his best to make this a 'hawkish' cut, aiming to discourage markets from pricing in back-to-back rate cuts.

EUR/SEK can break above the 11.75 highs simply on the back of lower SEK rates after the rate cut, but if the Riksbank manages to tame dovish expectations well enough, markets should still sell the rally around the 11.80 area amid a supportive risk environment for the krona.

Francesco Pesole

➔ BRL: Likely 25bp rate cut today

The Brazilian central bank (BACEN) is widely expected to cut its selic policy rate by 25bp to 10.50% today. This would break the trend of six consecutive 50bp rate cuts seen since last summer. Despite managing expectations for another 50bp reduction when it last met in March, BACEN's governor has since felt the need to communicate the greater chance of a 25bp cut today because of a more difficult environment both home and abroad. Domestically, BACEN remains concerned about fiscal slippage from the government – a factor to which the Brazilian real normally reacts poorly.

Yet despite the government recently revising down its fiscal surplus targets for 2025 and 2026, the Brazilian real has actually been performing quite well. Commodity prices have been moving in the real's favour and the recent decline in volatility, the search for carry and the softer dollar have all been helping.

In quiet markets, we think USD/BRL can probably stay gently offered on the back of a 25bp cut today. USD/BRL could continue to press 5.05, potentially even the 5.00 area were BACEN to sound a little less dovish. However, there are still some economists thinking that BACEN could push ahead with a 50bp cut today. That would probably prove a bearish surprise for the real.

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