

FX Daily: European FX showing some resilience

The Fed has now gone into a blackout period ahead of its rate meeting on 3 May. Investors will therefore this week be left to focus on 1Q23 US GDP, core PCE inflation, and the latest on the debt ceiling. European currencies have been showing some slight outperformance amid lower energy. Look out for big rate meetings in Japan, Sweden and Hungary this week



⬇️ USD: Debt ceiling negotiations coming into focus

Volatility levels in FX markets remain relatively subdued ahead of next week's central bank policy meetings in the US and the eurozone. Regarding short-term FX trends, we would continue to describe the mood as 'defensive'. Commodity currencies are under pressure in line with weaker oil prices. Our commodities team thinks Brent could stay on the back foot this week given that refinery margins are trending lower - suggesting recent weakness in the Canadian dollar and Norwegian krone may not reverse.

At the same time, US sovereign CDS spreads continue to rise as investors take out hedges against messy negotiations over the US debt ceiling. This week the House Republicans may well vote

through a debt ceiling extension into next year - but one which the Democrat-controlled Senate has vowed to reject given the embedded spending reductions. Therefore, we can expect little progress on the debt ceiling this week. Unless Friday's US March core PCE inflation markedly surprises above the consensus 0.3% month-on-month figure, expectations for one last Fed hike look locked in and we doubt the dollar needs to rally too much further.

Which currencies should outperform? Friday sees the first Bank of Japan policy meeting under new governor, Kazuo Ueda. The consensus expects it is too early to see any adjustments yet to the BoJ's Yield Curve Control policy - though changes may be forthcoming at the June meeting. However, given the still bubbling US banking crisis (First Republic Bank reports first quarter earnings today), we think the recent USD/JPY rally stalls under 135 and we remain happy with our 128 target for the end of the second quarter.

Given a DXY heavily weighted towards Europe and Japan currencies, we would favour DXY drifting back to the recent 101.50/65 lows, with a bias towards 101.00 later in the week.

Chris Turner

➔ EUR: European FX holding up well

European FX has outperformed in the G10 FX space over the last week, with the Swiss franc the strongest. EUR/USD continues to hold gains, with the market seemingly settled on the view that at least three more 25bp hikes from the European Central Bank will be forthcoming. Our macro team feels that next week's ECB credit/lending conditions survey will have a big say in whether the ECB hikes 25bp or 50bp.

But it is not just the ECB versus Fed tightening profile that is helping EUR/USD. The eurozone [April composite PMI](#) is pointing to a weak, services-led recovery and more insights on eurozone GDP growth will come with the 1Q GDP releases towards the end of this week. And today sees the German April Ifo - expected to hold onto recent improvements.

In all, we suspect EUR/USD can hold recent gains - even if the international environment (soft global growth and weak emerging market currencies) does not argue for a strong EUR/USD rally right now. EUR/USD can perhaps trace out a 1.0950-1.1050 range through the early part of this week.

Elsewhere, the Swedish krona has been enjoying a little more stability too. The Riksbank meets this Wednesday. Our team looks for a [hawkish 50bp hike](#), which should help keep EUR/SEK near this 11.30 area. Yet the fears of a banking crisis and greater scrutiny of the commercial real estate sector, where Swedish banks are heavy lenders, should mean that the krona will struggle to deliver outsized gains just yet.

Chris Turner

➔ GBP: Slow-burn re-assessment of sterling

Sterling was part of the European outperforming FX bloc last week, helped in part by sticky price data which has prompted quite an aggressive repricing of the Bank of England tightening cycle. Three further 25bp hikes are now priced. That re-assessment of UK factors was also echoed in the S&P rating agency on Friday, moving the UK sovereign rating outlook back to stable from negative - effectively acknowledging the changes in policy after the departure of former Prime Minister Liz

Truss.

The UK data calendar is quieter this week, but it seems the re-balancing out of short sterling positions by asset managers is ongoing - which could lend further support to GBP/USD in a quiet week. This could see GBP/USD edging back to the 1.2500/2550 area if we are right with our slightly bearish stance on the dollar this week.

Chris Turner

➔ CEE: It's getting more complicated

This week, the market's attention will once again return to the [regional story](#). Today, we will see March industrial and retail sales data and PPI in Poland, and consumer confidence in the Czech Republic. Our economists in Warsaw expect a 1.5% year-on-year decline in industry and a 6.2% YoY decline in retail sales, more or less in line with market expectations. Tomorrow's [National Bank of Hungary](#) (NBH) meeting will be the main market focus this week. As hinted last week, the central bank plans to start the process of monetary policy normalisation. If the forint does not sell off by then we think the NBH will make a bold move in cutting by 700bp in the overnight deposit rate to match the effective rate at 18%. On Wednesday, we will see data from the Polish labour market and then on Friday, Poland's April inflation figures will be released. We expect a further decline from 16.1% to 14.8% YoY, which is in line with market expectations. But core inflation will likely remain close to the March reading of 12.4% YoY.

Last week we highlighted that the rally in the region is running out of steam and we are likely to see the same scenario this week. Although conditions for CEE FX, in general, remain positive we are looking in vain for fresh momentum for new gains. The main focus this week will be on the Hungarian forint which will face NBH efforts to start normalising monetary policy. Further forint depreciation could be expected depending on the extent of the rate cut. However, we expect rather a minor second round of depreciation followed by stabilisation slightly above 380 EUR/HUF. The market was taking profits last week in the Czech koruna after a multi-week rally and we think it should not break above 23.600 EUR/CZK this week. On the other hand, further hawkish statements from the CNB ahead of Wednesday's start of the blackout period could help the koruna back to stronger levels.

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