

FX Daily: Falling volatility restores interest in carry trade

Cross-market volatility is falling again. This looks largely down to Friday's benign US jobs release and a relatively quiet US data calendar this week. We see the dollar trading ranges but are looking for some independent moves in the Swedish krona and British pound at this week's rate meetings. And lower volatility will keep the carry trade in demand



📈 USD: Softer NFP not enough to turn the dollar trend

It looks like Friday's slightly [softer US jobs report](#) has been enough to put paid to any ideas of a Fed hike this year. And Fed officials have also been keen to dampen speculation over a possible hike. And whilst the pricing of the Fed easing cycle this year has grown (45bp of cuts now expected for this year), the biggest impact of last week's FOMC/NFP double-header has been the decline in cross-market volatility. Here interest rate, equity and FX volatility are falling sharply again as the idea of divergent monetary policy trends gets scaled back. This environment may well last into next week's key release of US April CPI.

Lower volatility pumps more air into carry trade strategies. Here, the dollar does OK since it offers the highest short-term deposit rate in the G10 space. The New Zealand dollar and British pound should also out-perform in this environment, although the pound faces an event risk from

Thursday's Bank of England meeting, and we'll get to that shortly.

At the other end of the spectrum remains the Japanese yen. Low volatility and very low Japanese interest rates continue to see the yen as the funding currency of choice. Additionally, US Treasury Secretary Janet Yellen's comments that FX intervention should be 'rare and in consultation' have not helped Tokyo's efforts to stabilise the yen. It looks like this friction will be with us for some time and the market will test Tokyo's resolve by pushing USD/JPY back into the 155/156 area.

A very quiet US calendar this week, USD/JPY drifting higher, and perhaps some dovish developments in Europe (we're looking for a Riksbank rate cut tomorrow) should keep DXY supported this week, which may head back to the 105.50/75 area.

Chris Turner

➔ EUR: 1.07-1.08 looks the EUR/USD range

EUR/USD had a decent jump on the slightly softer-than-expected US jobs data on Friday. Yet unless US unemployment rises 'meaningfully', it will have to be the US price rather than the activity data, which determines the next big trend for the Fed and the dollar. As such, next week's April US CPI data will probably be the next sizeable mover for global FX rates. Before then, the eurozone calendar is reasonably light, and the 2024 ECB easing cycle looks fairly priced at 75bp - ING's house call as well.

As we have mentioned before, we think 1.08 represents a medium-term fair value for EUR/USD - which probably suggests EUR/USD can trade in a 1.07-1.08 range for most of this week.

One downside risk to European currencies comes from [tomorrow's Riksbank's policy meeting](#). Despite concerns over a softer currency, we think the Riksbank will cut. As we saw with the Swiss National Bank rate reduction in March, European rate cuts do add to the divergence theme and see European currencies underperform. This is an event risk for tomorrow.

Chris Turner

⬇ GBP: Thursday's BoE meeting the key driver

Were it not for the comments of Bank of England Chief Economist, Huw Pill, markets would be a lot more excited about a dovish shift in communication at Thursday's BoE policy meeting. As it is, our [core view](#) is that it will still be a little early for the BoE to shift its cautionary position and signal a June rate cut. The preference of our UK economist, James Smith, remains that the BoE cuts in August rather than June.

However, a June BoE rate cut is only 30% priced by the market and we doubt sterling has to rally too hard if the BoE's language on Thursday is unchanged. And we think investors will start to look at relative value trades involving sterling, such as short GBP/AUD, on the back of far stickier inflation in Australia, backed by the country's positive output gap.

For this week, the baseline would be EUR/GBP trading in a 0.8550-0.8600 range and upside risks on

a BoE dovish surprise on Thursday.

Chris Turner

📌 CEE: Global repricing blurring picture for the region

This morning, we've seen retail data in Hungary, and later, industrial production and foreign trade figures for the Czech Republic will be published. In fact, it's a busy data week for both countries, and we'll also get the National Bank of Poland's rate decision on Thursday (we're not expecting any change) and the important governor's press conference is on Friday. Watch out for Hungarian inflation numbers then too; we expect a slight increase from 3.6% to 3.7%, but core inflation should fall from 4.4% to 4.1% YoY.

In the FX market, Friday's US data once again shuffled the cards. The drop in global rates sparked a rally in CEE rates compressing the differential. Therefore, an even higher EUR/USD might not be the positive news for FX in the region as it might seem. The HUF has been ignoring rates for some time, in our view, and so the Friday move only increases its over-valuation. With data being released in Hungary this week, we could see EUR/HUF move back up to 393 and HUF is the most exposed to depreciation in the CEE region at the moment in our view.

EUR/CZK briefly moved below 25.0, but as we mentioned earlier, the current repricing after the CNB meeting last week is rather dovish and negative for the CZK. Therefore, we see levels more around 25.10. PLN is the only currency in the region which could see some gains in the coming days. In particular, a hawkish NBP could add momentum to PLN outperformance in the CEE region with a move back towards 4.30 EUR/PLN.

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