FX Daily: FX markets position for May tightening

The dollar found support on Friday from comments from Fed hawk Christopher Waller. A lighter data calendar this week suggests the focus will be on central bankers jostling for position on the need for and size of some final monetary tightening in May. We doubt the dollar needs to rally too far. We also see the risk of profit-taking in long HUF and CZK positions

USD: Focus on Fed talkers and taxes this week

The dollar enjoyed a lift on Friday from some comments from Fed hawk, Christopher Waller. His comments, released exactly the same time as a mediocre set of March retail sales data, somewhat surprisingly saw US two-year yields rise 10-15bp and lifted the dollar. The market now prices 21bp of a Fed hike on 3 May.

Looking ahead this week, the US data calendar is relatively light but there are a lot of Fed speakers all week. With the market conditions continuing to settle a little (e.g. MOVE US Treasury implied volatility dropping back to lows seen in early March), it seems likely now that the Federal Reserve will deliver one last 25bp hike in May and then hit the pause button to wait on the effects of tighter credit conditions caused by the March banking turmoil. With that 25bp May hike now priced, the dollar may not need to rally too much further in the short term.

Also in focus, this week will be federal tax receipts as the 18 April tax deadline passes. The relevance of this is that the size of tax collections will determine how much time the US Treasury has until the 'X' date, when emergency and stop-gap funding measures run out and parts of the US government may have to be shut down. Currently, the 'X' date is seen in the mid-July to mid-August time frame and we are already seeing a hump in implied US Treasury bill yields around that point. Equally, the one-year US Treasury CDS continues to trade near 100bp as investors brace for an unthinkable default on US Treasury debt. We mention this as a background factor that may start to weigh on the dollar over the coming months.

Back to the short term, a quiet day could see DXY trade in a narrow 101.00-102.00 range. And tonight's release of US February TIC data could shed light on whether foreign official institutions are continuing to reduce holdings in US Treasuries.

Chris Turner

EUR: Hawks and doves battle it out

Ahead of their policy meeting on 4 May we are seeing the European Central Bank hawks and doves making their cases. The hawks argue that a 50bp hike should still be on the table, while the doves - most recently Mario Centeno - argue that the slowdown in headline inflation could even make the case for a pause. Currently the market prices in 32bp of tightening on 4 May. Our team looks for a 25bp hike. Were market expectations to shift more fully behind a 50bp hike, the euro could get a further lift. Therefore, look out for key ECB speakers this week, such as President Christine Lagarde at 17CET today and Isabel Schnabel on Wednesday. The week will conclude with a fresh look at business confidence on Friday when the flash April PMIs are released. Here the data continues to look mixed.

EUR/USD reversed quite sharply from a new high at 1.1075 on Friday. Failure to reclaim the 1.1020/30 region quite quickly could leave it vulnerable.

Chris Turner

GBP: Big week for UK data

As our UK economist, James Smith, discusses here, it is a big week for UK data and what it means for the Bank of England's policy decision on 11 May. Currently, the market prices a 19bp hike, but James thinks the chances of a pause are under-appreciated. The big data releases kick off tomorrow.

GBP/USD has once again stalled over 1.25 - largely on the dollar story, although EUR/GBP is notably higher at 0.8850 too. We suspect EUR/GBP could trade 0.89+ were the market this week to price out the chances of that May hike.

Chris Turner

CEE: Lack of local story can trigger profit-taking

This week we have an extremely light calendar in the CEE region and so the focus will be more on the global story. Today we will see core inflation in Poland. Our team in Warsaw expects a rise from 12.0% to 12.3% year-on-year, slightly above market expectations. On Wednesday, PPI numbers in the Czech Republic for March will be released and a further decline can be expected. However, more attention may be paid to agriculture prices given that food prices are still pushing headline inflation up. And on Friday in Poland, labour market data will be released. Year-on-year wage growth is expected to slow but month-on-month wage growth is expected to accelerate again, which combined with sticky core inflation could be a problem for the National Bank of Poland. We may also hear more hawkish comments from the Czech National Bank this week as the May meeting approaches. On the sovereign rating side, S&P confirmed the rating and outlook for Romania and the Czech Republic on Friday.

In the FX market this week we will have to look more at the global story. As we mentioned last week, the current rally in CEE FX should stall or at least slow down in our view. Although conditions remain positive at the global level, the current drivers are running out of steam. With the fragile global story, it is hard to see another push to support the CEE region. Additionally, the positioning of the major players, the Hungarian forint and Czech koruna, is starting to get very heavily long again in our view and we could potentially see some profit-taking this week without local momentum. For now, we see the forint stabilising around 374 EUR/HUF and the koruna around 23.30 EUR/CZK. The Polish zloty is showing some gains for the first time this year, however, the fragile global story may again halt any further advance around 4.650 EUR/PLN.

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