FX Daily: Hawkish pushback

We expect the Czech National Bank to follow other European central banks with a hawkish tone today, which may favour a repricing of rate cut expectations and a higher CZK. Dovish bets have also been scaled back in the US, but we continue to see mostly downside risks for the dollar, and expect EUR/USD to test 1.10 soon. But beware of corrections along the way

The Czech National Bank headquarters in Prague, Czech Republic

USD: Fed's lack of clarity counts more than the magnitude of cuts

FX markets continue to move in line with our baseline view: the lack of clear guidance from the Federal Reserve and hawkish rhetoric in Europe is favouring a weaker dollar amid a calmer risk environment. It's important to note how the dollar has softened since the start of this week despite some substantial unwinding of dovish bets on the Fed funds futures curve. Markets moved from pricing in a 24% chance of a hike in May and 88bp of cuts by year-end on Friday to a 47% implied probability of a hike in May and 46bp of cuts by year-end as of this morning. In a way, this is telling us how it's the stance of the Fed and its unclear communication (especially given the contrast with the European counterparts) that leaves the dollar vulnerable in a stable risk environment and not necessarily the magnitude of expected rate cuts.

So, is it going to be a straight-line dollar depreciation from now on? We don't think so. The room for corrections is non-negligible, and those can be triggered either by new risk-off waves outside of the US (like the one seen in Europe on Friday) or by attempts from Fed members to re-establish more hawkish rhetoric. While the first of these two triggers is harder to predict, the chances of a more hawkish tone in upcoming Fedspeak might have increased after a few days of market calm and investors scaling back ultra-dovish expectations. However, the bias for the dollar remains mostly bearish in our view.

The US data calendar only includes pending home sales today, after yesterday's consumer confidence came in on the strong side. In terms of Fed speakers, Fed Vice Chair for Supervision Michael Barr will speak before the House Financial Services Committee after his testimony at the Senate's committee yesterday.

This week is seeing oil currencies coming to the fore. With crude prices having now rebounded more than 12% since the 20 March bottom and re-approaching $80/bbl, the soft-dollar and more stable risk environment is offering room for Norway's krone, the Canadian dollar and the Mexican peso to rally. Of those three, we continue to see MXN and NOK in a more advantageous spot than CAD given ongoing domestic tightening cycles. Banxico will announce policy tomorrow and we expect a 25bp hike in line with market expectations.

Francesco Pesole

EUR: 1.10 within reach

Yesterday, we heard European Central Bank policymaker Georg Muller joining the rhetoric of other hawks like Isabel Schnabel in signalling how the focus should remain on inflation and that there is still room to raise interest rates. Schnabel herself – as well as another hawk, Peter Kazimir - will deliver remarks today, while the data calendar in the eurozone is quite light until inflation flash estimates are released on Friday.

The EUR-USD 2-year swap rate differential has shown extreme volatility lately as Fed rate expectations have swung widely. The spread ranged between -75bp and -100bp (where it is now) in a matter of a few days. As discussed above in the USD section, the magnitude of the Fed rate cuts does not matter all that much for the dollar's direction at the moment. Markets are preferring to stay on the more hawkish side (Europe) and the swap rate spread has tightened enough to warrant a higher EUR/USD in a stable risk sentiment environment, without that spread having to reach the extremes of -70 or -60bp seen in the past weeks.

In our dollar section, we also discussed how the chances of corrections are non-negligible and may have actually increased in the past few days, but there are not enough elements to conclude that the euro should lose its upside momentum now. So, 1.10 should be within reach in the near term. That is a key benchmark level and could see significant resistance: a break higher would likely signal a more structural shift in market strategic views for a stronger euro.

In the crosses, we saw EUR/GBP fall below 0.8800, but we don't expect the pair's weakness to be very sustainable as we see the market pricing for Bank of England tightening as too aggressive and policy divergence should be a primary driver for a higher EUR/GBP.

Francesco Pesole

CZK: CNB puts on hawkish jersey again

Today's calendar includes a monetary policy meeting of the Czech National Bank (CNB), the first since the start of the recent turbulence in global markets. In line with surveys, we expect interest rates to remain unchanged. Thus, the main focus will be on the CNB governor's press conference. Over the past two weeks, market expectations have shifted in a significantly dovish direction and the market is currently pricing in roughly 120bp of rate cuts by the end of this year. Thus, we expect the hawkish tone to trigger a pushback and today's meeting will be an opportunity to reassess these expectations.

The Czech koruna thus has the perfect conditions for a recovery, in our view. Together with the Hungarian forint, the koruna has the highest beta against the global story and higher EUR/USD and low energy prices are playing into its hands. Moreover, we expect the CNB to confirm its readiness to intervene in the FX market should the koruna move higher. Thanks to that, the potential loss is limited and moreover, we believe the market is not ready for CNB intervention levels at the moment, which we estimate at around 24.60-24.70 EUR/CZK. Moreover, the koruna maintains decent carry within the CEE region. Thus, overall, we believe the koruna has the best risk/reward within the region at the moment and we expect a move below 23.50 EUR/CZK today.

Frantisek Taborsky

HUF: Favourite carry trade is back

As we expected, yesterday's meeting of the National Bank of Hungary (NBH) brought a clear hawkish message that an interest rate cut is not on the table at the moment. According to the Monetary Council's assessment, maintaining the current level of the base rate for a prolonged period will ensure that inflation expectations are anchored and that the target is achieved in a sustainable way. So the most important takeaway from this month's rate-setting meeting is that the NBH will remain cautious, patient and disciplined.

As we mentioned earlier, the Hungarian forint, together with the Czech koruna, is our favourite currency in the region at the moment. The NBH has made it clear that priced-in rate cuts are not on the table at the moment, which should keep FX carry by far the highest in the region. This was the main reason why the forint was one of the most popular macro trades within the EM space during January and February. Thus, we believe that current market conditions along with the hawkish NBH are enticing investors to return to Hungary and the forint has further room to rally. As such, we expect the forint to settle below 380 EUR/HUF for the rest of the week.

Frantisek Taborsky

Authors

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

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