

## FX Daily: IMF warns of a 'perilous phase'

In releasing its latest World Economic Outlook earlier this week, the IMF warned that the global economy was entering a 'perilous phase'. One of the reasons cited was sticky inflation. Today's US March CPI release will shed light on whether inflation has turned the corner or the Fed needs to tighten further. A high number risks supporting the dollar into May



### ➔ USD: US March CPI to set the tone

In releasing its [World Economic Outlook](#) earlier this week, the IMF warned that slowing global growth, sticky inflation, the risk of financial instability coupled with structural factors like climate change and global fragmentation all contributed to the global economy entering a 'perilous phase'. Notably global growth was going to be led lower by declines in the Advanced Economies as recent tightening cycles hit home. And the IMF felt that tight monetary policy was still the appropriate course of action now.

Financial markets are probably a little further ahead than the IMF and while allowing perhaps for one last Federal Reserve rate hike over coming months are very much focused on the US hard landing and a 200bp Fed easing cycle over the next 24 months. Important for that benign outcome will be the path of inflation and today sees the latest update from the US. Core US CPI has been

one of the biggest FX movers over the last 12 months and today's March release is expected to show [another sticky 0.4% month-on-month reading](#). Sticky inflation is probably the biggest risk to the consensus views in the FX market right now that EUR/USD and USD/JPY end the year at 1.12 and 125, respectively.

Tonight also sees the release of the 22 March FOMC minutes, where the Fed pushed ahead with a 25bp hike after recently announcing new dollar liquidity programmes. Undoubtedly there will be a lot of noise in the minutes and it is unclear what they will mean for current market pricing of a final 25bp hike in May (75% priced) and a subsequent 60bp easing cycle by year-end. Expect DXY to be driven by any surprises on the March CPI today and the sharper reaction (risk negative, dollar rally) would probably come on an upside surprise.

*Chris Turner*

## ➔ EUR: 1.10 should prove a tough nut to crack

EUR/USD is enjoying some gentle support as investors return from their Easter break. As above, US core CPI will be the key event of the day and will determine whether EUR/USD has a chance of breaking above 1.10. Two-year EUR:USD swap differentials are pretty steady at near 100bp in favour of the dollar. Perhaps we should not expect too much further narrowing now. Two-year US Treasury yields are already trading at a 100bp discount to the Fed funds rate, a discount which could move to 125bp if the Fed hikes in May. Historically, the 125-150bp marks a deep historic discount for US two-year yields, and much substantial further downside for two-year yields may only emerge when the Fed is ready or has started easing - probably in the fourth quarter. In short, [our base case](#) is that EUR/USD will struggle to sustain a break above 1.10 this quarter.

Apart from the US CPI, look out for several European Central Bank speakers today. The mood music seems to be that inflation remains sticky, meaning that expectations for a further 50-75bp of ECB tightening this year will hold. EUR/USD to trade a 1.0900-1.0950 range into the pivotal US CPI release.

*Chris Turner*

## ➔ GBP: New MPC member probably less dovish

[Megan Greene](#) has been announced as the new external member of the UK's Monetary Policy Committee. We doubt she can be anywhere near as dovish as Silvana Tenreyro, whom Greene is replacing. However, the main focus for sterling markets in the near term is whether the Bank of England (BoE) will push ahead with one last 25bp hike on 11 May. This would take the Bank Rate to 4.50%. The market prices an 80% chance of such an outcome, while our team thinks the BoE could stay on hold.

Providing insights into the latest BoE thinking will be Governor Andrew Bailey, who speaks in Washington today at 15CET. There is a risk that he hints at a pause, having seen fellow central bankers in Australia and Canada do so over recent months. On that subject, the Bank Of Canada is widely expected to keep the policy rate at 4.50% when it meets today, with the market pricing a 25bp cut by the end of the year.

Back to sterling. US CPI and Governor Bailey's speech should be the key drivers today. We see 1.25 as a strong barrier for GBP/USD and favour EUR/GBP higher - especially if the BoE governor gives a

nod to a pause in May.

*Chris Turner*

## **HUF: Room for rally is shrinking but still the currency of choice**

Today's main numbers in the CEE region were released this morning. Hungarian inflation fell from 25.4% to 25.2% year-on-year in March, slightly above market expectations. This implies a second consecutive month of decelerating inflation since the January peak at 25.7% YoY. The market is currently pricing in a rapid rate cut essentially from the next meeting of the National Bank of Hungary at the end of April. However, we believe that the central bank wants to see more evidence that the situation is under control, and we expect the first changes in monetary policy only in the middle of the year.

Since mid-March, the Hungarian forint has made by far the biggest gains against the euro (5.8% excl. carry) in the EMEA space and remains our favourite currency together with the Czech koruna. However, as we mentioned yesterday, the room for a further rally is getting smaller. At the global level, EUR/USD will not deliver another significant boost anytime soon and the market has almost fully normalised after the March turmoil. At the local level, we won't get much more positive from the energy story either. Moreover, the market positioning is becoming heavily long again in our view. We believe the forint may touch 370 EUR/HUF in the foreseeable future, but 375 EUR/HUF will remain the point of gravity. Nevertheless, by far the highest carry in the region and the normalisation story after a negative year will, in our view, keep the forint popular within the CEE region and thus continue to be our currency of choice.

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