

FX Daily: Policy divergence leaves dollar vulnerable

Markets have reassessed the risks to European lenders and looked considerably less concerned as markets re-opened on Monday. If this calm in Europe continues, monetary policy divergence is what may be left driving most FX dynamics, and the stark divergence between Fed and European central banks' narratives points to dollar downside risks



We think that as long as fears of banking contagion remain relatively quiet in Europe, the balance of risks for the dollar should remain tilted to the downside

📉 USD: Fed rate expectations keep bouncing around

Risk sentiment recovered yesterday as markets appeared calmer about the health of European lenders which had generated a sell-off on Friday. The narrative that banking turmoil was shifting back from the US to Europe was the key driver of a dollar rebound at the end of last week, and we are not surprised to see investors' tentative optimism at the start of this week coincide with USD weakness.

The key reason is that, when stripping out the risks of financial contagion in Europe, monetary policy still seems to be heading in two different directions in Europe and the US. We'll expand on ECB and Bank of England comments in the EUR and GBP sections below, but we can definitely see how European central bankers are more comfortable than their US counterparts when pushing ahead with a hawkish narrative. A case in point: Neel Kashkari – one of the FOMC's biggest hawks –

warned about the economic impact of a credit crunch and implicitly suggested less need for tightening.

Since the Fed is not offering a hawkish narrative to lean on, market pricing of future rate moves remains strictly tied to news on financial stability. Consequently, Fed rate expectations have become an accurate measure of market sentiment about the banking turmoil. Since the end of last week, markets have priced out a rate cut in July (pushed it to September), and now expect 60bp of easing by year-end as opposed to almost 90bp. That is probably due to the beneficial effect of First Citizens acquiring Silicon Valley Bank over the weekend.

Today, the US data calendar includes the Conference Board consumer confidence figures for March, the Richmond Fed manufacturing index (also for March) and February's wholesale inventories. Fed Vice Chair for Supervision Michael Barr will testify before the Senate Banking Committee.

In FX, we think that as long as fears of banking contagion remain relatively quiet in Europe, the balance of risks for the dollar should remain tilted to the downside. We could see markets once again favour JPY for tactical defensive positions.

Francesco Pesole

EUR: Schnabel keeps hawkish tone going

Isabel Schnabel reinforced her profile as one of the most hawkish members of the ECB governing council yesterday, as she said she wanted the ECB March statement to include a reference that more hiking was possible. Her comments likely helped push market rate expectations in the eurozone a little further: 46bp of tightening is now priced in by September.

Today, we'll hear from other ECB members. President Christine Lagarde will speak at a BIS event this afternoon, where Joachim Nagel and Francois Villeroy will also participate. We'll also hear from Madis Muller, Bostjan Vasle, Gabriel Makhlouf and Pablo Hernandez De Cos. On the data side, the German Ifo index [came on the strong side yesterday](#) (at 93.3 from 91.1 in February), but the calendar does not include market-moving releases today.

We think EUR/USD can retain some bullish momentum on the back of the ECB's hawkish narrative and calmer investor nerves on the European banking situation. Our view remains that 1.10 can be reached quite soon, although bumps along the way are highly likely.

Francesco Pesole

GBP: Bailey helping the pound

Bank of England Governor Andrew Bailey sounded relatively hawkish in his remarks yesterday. While saying that rates should not be taken to the 2008 peak, he stressed how the UK banking system is in a sound position and that inflation remains the key focus, and that further rate hikes are possible if inflationary pressures persist. Bailey will testify today about the SVB collapse and we may hear some details about the Bank's macroprudential measures.

With BoE rate expectations now supported, we think GBP/USD can head towards the key 1.2426 (December high) and 1.2500 resistances on the back of USD weakness and policy divergence relatively soon.

Francesco Pesole

HUF: NBH to confirm hawkish tone

The National Bank of Hungary (NBH) is [meeting](#) today for the first time since the start of the recent turbulence in global financial markets. We expect rates to remain unchanged, in line with market surveys, and a hawkish tone. Although we have already seen the peak in inflation and an improvement in the current account deficit, the forint's return to the 400 EUR/HUF level again will not allow the NBH any hints of dovish signals, in our view. The meeting will also bring an updated central bank forecast, however, we are unlikely to see any game-changer today.

On the FX side, the Hungarian forint has maintained the highest beta against the global story, which, assuming favourable global conditions, creates room for a significant recovery. We believe the recent sell-off has cleared the very heavy long positioning that previously blocked further forint appreciation. The renewed rally is also supported by the energy story with the gas price testing new lows. Moreover, with the forint having by far the highest carry within the Central and Eastern Europe region, it will once again attract investors to the HUF market. Thus, in our view, today's hawkish meeting should support the new gains and push the forint below 385 EUR/HUF.

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