

## FX Daily: Post-CPI trading may lead to fragile yen

There's a good chance we have entered a calm period in markets, one that separates the US CPI and PCE releases and that could see the dollar stabilise and the yen face some pressure. The highlights of this week are the FOMC minutes and PMIs, which may not drive major market moves. Developments in Iran and Saudi Arabia have so far had a contained market impact



### ➔ USD: Watch for a rising USD/JPY

May has so far brought a weak dollar, strong risk sentiment, and growing expectations for Federal Reserve easing. A data-gripped market may, however, need to find the next catalyst for a big move outside of data. Our US economist notes that existing homes sales and durable goods orders should be soft this week, although that appears to be a consensus call. The same should be true for the S&P PMIs on Thursday, which are anyway secondary in importance to the ISM surveys.

Wednesday's FOMC minutes (1 May meeting) could be quite interesting. Remember that the May meeting disappointed the hawks and some members (like Neel Kashkari) have since then tried to feed markets the risk of another hike if necessary. The focus will be on the reasons for the

committee to stay generally optimistic on disinflation, which can guide the future data-monetary policy reaction function.

Barring surprise references to rate hikes or a very dovish consensus view in the committee, the short-term implications for the FX market may not be huge, and a wait-and-see, low volatile environment may be the norm ahead of the 31 May core PCE print. A stabilisation in the 104/105 area in DXY is our base case for this week, although we see the balance of risks as slightly tilted to the upside as markets may further unwind the post-CPI rally in pro-cyclical currencies. Some upside risks for the dollar may also stem from a tightening in the oil market following the death of Iran President Ebrahim Raisi in an helicopter accident and some health concerns for Saudi King Salman Bin Abdulaziz. So, far the market impact of these Middle East developments has been contained.

Remember that the yen is often an underperformer in low-volatility environment as yen-funded carry trades grow in popularity. There is no denying this is a rather stretched strategy in FX, and a net short JPY positioning worth 42% of open interest as per CFTC data is a testament of this. At the same time, that same short positioning gauge was at 54% a month ago – and should the market start to doubt the sustainability of Japan's FX interventions, picking a top for USD/JPY will prove tricky. For now, we think that a move back to the 156.50 pre-US CPI region is very much possible this week. If expectations for a slowdown in Japanese inflation in April are confirmed this Friday, a new leg higher can be unlocked in USD/JPY.

Elsewhere, New Zealand's central bank will announce policy this week. As discussed in our meeting [preview](#), slow disinflation should not prompt a material dovish shift by policymakers despite a recession and looser jobs market.

*Francesco Pesole*

## ➔ EUR: PMIs can endorse growth optimism

The highlights of the week in the eurozone are the PMIs on Thursday and two speeches by European Central Bank President Christine Lagarde. Expectations are for a further improvement in both the manufacturing and services gauges, although the former should stay in contraction territory.

The euro has mildly benefitted from the improvement in the domestic growth outlook. Whether this can continue depends not only on indicators like the PMIs, but mostly on whether this will make the ECB turn more cautious on its easing plan beyond the highly likely June rate cut. Still, market pricing has not been very volatile as of late for the ECB, and we have some doubts PMIs can shake the euro substantially.

We had deemed the rally to 1.09 as a bit overdone given lingering concerns on the US disinflation story, and still see a greater likelihood of a stabilisation in the 1.08-1.09 area rather than a decisive break higher. However, a very data-sensitive market has shown reactivity (even if short-lived) to a variety of data releases, and while 1.10 does indeed look stretched, some exploration in the 1.0900-1.0950 area is possible – perhaps if eurozone PMIs look particularly stronger than the US ones.

*Francesco Pesole*

## ➔ GBP: Key inflation read this week

Wednesday's CPI print in the UK will be a pivotal moment for the pound. In our view, inflation data for April holds the keys to a June rate cut by the Bank of England. The Sonia curve currently prices in 14bp of easing for June and 25bp for August.

Our economics team thinks that services inflation will come slightly hotter than the BoE's forecast, which should tilt the balance in favour of August for the first cut. This is, however, a close call – and potentially a very binary event for the pound as bets on a June rate cut could swing substantially. Governor Andrew Bailey will deliver a speech tomorrow.

If we are right with our CPI call, expect sterling to have a good week. EUR/GBP may move back below the 0.8550 and retrace April's path, when after a spike above 0.8600 the pair fell to 0.8530. Such a drop would, however, make EUR/GBP rather cheap in our view as the BoE may end up delivering more cuts than the ECB by year-end.

*Francesco Pesole*

## ⬆️ CEE: Risk-on mood supports the region

Today in the Czech Republic, the PPI including agriculture prices will be released, which might tell us something more about the rise in CPI food prices. The National Bank of Hungary is scheduled to meet tomorrow. Along with market expectations, we forecast a 50bp rate cut to 7.25% and a hawkish tone at the press conference indicating a slowdown or pause in the cutting cycle in the second half of the year. On Wednesday in Poland, we will see industrial and labour market numbers indicating an economic recovery and a tightening labour market. On Thursday, retail sales will be released in Poland, while over in Turkey we expect the central bank to leave rates unchanged but maintain its tightening bias.

Markets remain in risk-on mode supporting EM FX. In the CEE region, we remain positive given that FX market should catch up with core markets, especially the weaker USD. However, already on Friday we saw some tightening in interest rate differentials across the board, dampening the effect of a higher EUR/USD. So for today, we are rather neutral and may see some minor retracement of gains from previous days. But for the rest of the week, conditions should remain positive and the CEE region should still remain on the stronger side. PLN in particular could see some correction as the biggest outperformer in the region, but in our view this would just be an opportunity for the market to go long again.

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