

FX Daily: Pushing forward into de-escalation trades

Markets are increasingly pre-empting a positive outcome as the US and Iran prepare for a new round of talks. We still think caution is warranted and the balance of risks for the dollar now looks tilted to the upside. Central bank speakers remain in focus today, while we see some downside risks for Australian jobs numbers overnight



The dollar has taken another hit on Middle East optimism

USD: Aggressive optimism

The US dollar index is trading at only around 0.5% above pre war levels. Markets have grown more confident that the Middle East crisis is moving toward a resolution, with the US and Iran arranging a second round of talks, and Tehran seemingly willing to halt shipments to avoid testing the US naval blockade.

Given how unsuccessful the first round of negotiations was last weekend, these dollar levels seem to embed a fair amount of premature optimism. As such, the balance of risks is increasingly skewed to the upside for USD.

Part of yesterday's dollar weakness was driven by a much softer than expected March PPI print (0.5% MoM), which helped markets settle around -10bp of Fed easing priced by year end. Today,

attention turns to the Fed's Beige Book – an anecdotal survey that often shapes policy thinking. We expect it to point to greater corporate caution, subdued hiring and ongoing inflation pressures, but nothing that would materially shift pricing. Alongside Fed speakers, we will also watch February TIC flows to gauge whether foreign sentiment toward US Treasuries was deteriorating before the war.

On another note, it was announced yesterday that Fed Chair nominee Kevin Warsh's Senate hearing will take place at 10AM ET on 21 April. We see no kink in the dollar's implied volatility structure, suggesting greater anticipated risk around the event. To us, the risks are probably on the downside for USD and front-end USD rates, considering markets aren't pricing in a full cut by year-end.

While tariffs have fallen into the background of late, Scott Bessent suggested overnight that tariffs could return to their pre-SCOTUS ruling levels in July. That can add a layer of USD bearishness.

Francesco Pesole

📌 EUR: More ECB speeches today

ECB President Christine Lagarde did not offer any new guidance in her US speeches yesterday. She did, however, note that the economy currently sits between the ECB's baseline and adverse scenarios. If anything, this could be read as a mildly dovish nuance, although it clearly remains incomplete without any reference to inflation dynamics or the policy response. Importantly, other ECB members have not struck a more dovish tone: Dolenc and Makhoulouf openly discussed hikes, while Rehn stuck to a more generic note of caution.

For now, this should reinforce the view that the ECB will still deliver two rate hikes even under a gradual de escalation scenario. That said, the marginal support for the euro is diminishing, with other European DM currencies outperforming EUR so far this week. Lagarde speaks again in DC today, alongside a number of other ECB members.

We argued yesterday that for a move above 1.180 in EUR/USD to be sustainable, greater clarity on a peace plan would be needed. That clarity is still lacking, yet markets appear to be increasingly pre-empting a positive outcome. At this stage, risks look more skewed to the downside, although tangible progress in negotiations could still allow the rally to extend beyond 1.1850 by the end of the week.

Francesco Pesole

📌 GBP: Bailey staying cautious

Expectations for Bank of England tightening continued to abate yesterday, with pricing for December falling 10bp to 34bp. Alongside optimism on a conflict resolution, BoE officials continue to sound comparatively less hawkish than their ECB counterparts.

Yesterday, both Andrew Bailey and Megan Greene stressed again the need to take second-round effects into consideration (which, in our view, will be limited in the UK) and pointed to patience before assessing the policy implications. Bailey speaks again today.

All in all, the latest developments keep us confident with our call that front-end rates have further to fall in the UK than the eurozone and that should offer lasting support to EUR/GBP beyond the

near-term. For now, the pair is suffering a bit from improved risk sentiment, but rate differentials will return as primary drivers once the dust has settled.

Francesco Pesole

📉 AUD: Downside risks for jobs figures

We see some downside risks to Australia's March jobs figures, due at 02:30 BST tomorrow. Consensus at +20k for the typically volatile payroll print looks somewhat optimistic, given the clear tendency over the past year for negative reads to follow runs of positive data. Another positive print in March would be the first time since 3Q24 that employment has risen for three consecutive months.

We could see the unemployment rate edge up from 4.3% to 4.4% on the back of a softer jobs print and an unchanged participation rate. This should not yet reflect war related effects, but it could signal slightly softer labour market momentum heading into the conflict period.

Would that be enough to avert a May hike by the RBA? We doubt it, for now. RBA officials have repeatedly expressed concern about losing control of inflation expectations and have openly pointed to the need for further tightening. We sense a degree of urgency, and our base case remains a May hike rather than waiting until August. Markets are pricing around 15bp for May, but that could turn more hawkish once CPI data (released on 29 April) show a jump toward the 4.5% area.

We think AUD/USD retains solid upside potential, net of re escalation risks. A peace deal would not necessarily imply a return to pre war energy prices, allowing AUD to benefit from both stronger export prices and improved risk sentiment. With the RBA continuing its hawkish cycle, we are starting to see some upside risks to our 0.720 call for this quarter.

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