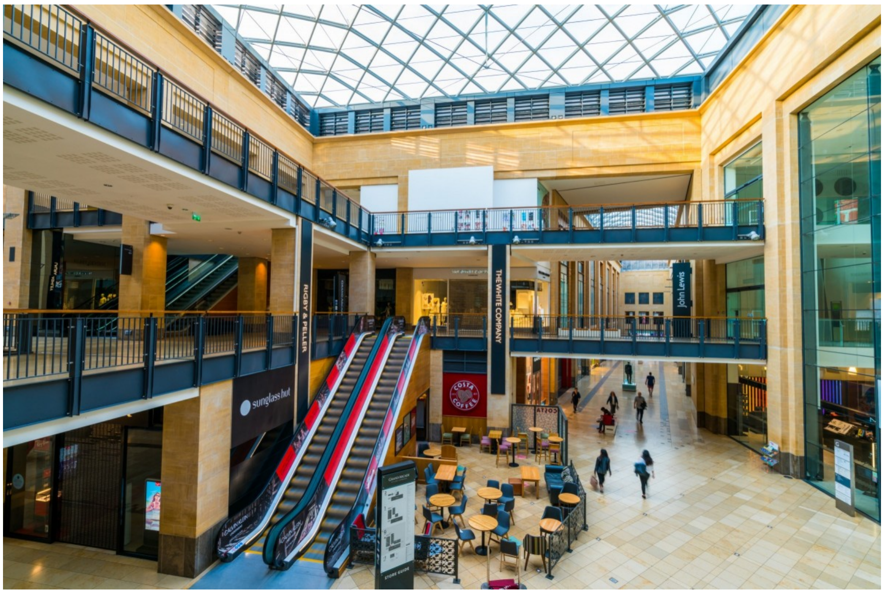
FX Daily: Quiet end of the week, bearish USD bias persists

This week's US data has been firmly on the dovish side: lower than expected inflation, soft core retail sales, and most activity surveys still weak. Today's highlight is the University of Michigan surveys, but we feel markets may be comfortable with EUR/USD close to 1.120 while retaining a strategic bearish bias on the dollar



The University of Michigan consumer sentiment survey could have some impact on FX today, especially when it comes to inflation expectations.

USD: Dovish momentum re-emerging

This week's data flow has been quite dovish for the Federal Reserve. After the soft April CPI, PPI dropped by 0.5% month-on-month, against expectations of a 0.2% rise, with significant upward revisions for March data. Regarding year-on-year levels, headline PPI decreased from 3.4% to 2.4%, while core PPI fell from 4% to 3.1%. Retail sales increased by 0.1% MoM, slightly above the consensus of 0.0%. However, the control group, which excludes volatile items like gasoline, autos, and building materials, showed a decline of 0.2% MoM, against expectations of a 0.3% increase. Since this is a nominal figure, it needs to be adjusted for inflation to reflect real growth as measured in GDP, which would result in a decrease of approximately 0.3% to 0.4%.

The USD OIS 2Y swap rate has adjusted 10bp lower from the 3.8% peak, but does not seem to be taking the dovish signals from data at face value given the tariff distortion, and pricing for a Fed cut before September remains below 50%. The dollar short-term rates relationship has loosened in the past two months, but the market's bearish USD tendency means further dovish repricing could prove to be the catalyst for fresh dollar short building.

There aren't any tier-one data releases in the US today. Housing starts are expected to have increased in April, while import prices should have dropped on the back of lower oil prices. The University of Michigan surveys have some FX impact potential, especially when it comes to inflation expectations. The median response for the expected change in prices over the next year spiked from 2.8% in December to 6.5% in April. Markets are understandably treating these figures with caution: the sample size is only 500 households, and some political bias in the responses may be skewing the result.

This week's price action suggests waning momentum for the dollar to close its lingering risk premium. The risks remain skewed to the downside for DXY as strategic dollar shorts remain prevalent, and the 100.0 support could be retested sooner rather than later.

Francesco Pesole

EUR: Tied to 1.12, but looking up

The euro has been only marginally impacted by domestic news this week. 1Q growth was revised a touch lower from 0.4% to 0.3% yesterday, although March industrial production figures were stronger than expected.

After a moderate hawkish repricing in the wake of the US-China trade deal, markets and consensus seem to be aligning around two rate cuts by the European Central Bank this year, which is also our call. ECB speakers have so far offered very little pushback against this view. This week, members from both sides of the spectrum - like the dovish-leaning Francois Villeroy and the hawk Klaas Knot - sounded confident that US tariffs won't stoke eurozone inflation. Earlier, Latvia's Martins Kazaks (hawkish-leaning) said a June cut is a "pretty possible step".

We still see 1.120 as a good short-term anchor for EUR/USD, although the bias seems to be for testing 1.130 rather than 1.110 in the short term on the back of lingering USD strategic selling. As discussed in our latest edition of FX Talking, we have a one-month target of 1.12 and end-of-June target of 1.13.

Francesco Pesole

CEE: Region elects new leadership

Secondary inflation data will be released in the region today:

- In Poland, we will see core inflation for April, which likely fell from 3.6% to 3.4% YoY, according to our calculation based on yesterday's final numbers, which also revised headline inflation by 0.1pp to 4.3% YoY.
- In Turkey, May inflation expectations will be released, closely watched by the central bank. We saw some pick-up in April after the sell-off in FX. It will be interesting to see if this is a new trend or if we see a decline after lower headline inflation in April.
- The Czech National Bank publishes the minutes from last week's meeting. We should see a hawkish discussion of further rate cuts and an upward inflation profile. We'll also see who voted for a pause (6-1 in favour of a rate cut) last week. We are expecting this to be Deputy

Governor Eva Zamrazilova.

In Romania, the National Bank of Romania meets today. We expect rates to remain unchanged despite the current volatility in the markets. However, the main focus will be whether the central bank will mention FX and market intervention. Yesterday, the market saw renewed pressure on spot and forward FX and subsequently in the bond market after several days of relief. We could see pre-positioning ahead of the weekend when the second round of the presidential election takes place. EUR/RON has stabilised around 5.100 but the spike in forwards indicates more upward pressure on spot. Polls show a close contest between the candidates with no clear favourite.

Also in Poland, this weekend we will see the first round of the presidential election, where the government candidate is clearly leading in the polls. In all likelihood, the candidate of the main opposition party will also make it to the second round and we will see a closer contest in two weeks' time. The markets are likely to focus mainly on the result of the second candidate, which will determine how close the contest will be.

Frantisek Taborsky

ZAR: New, improved inflation target helps the rand

The rand rallied 1% yesterday on news from the finance ministry that changes to the central bank's inflation target would be announced 'very soon'. Currently, the South African Reserve Bank (SARB) targets inflation in the middle of a 3-6% range. The speculation is that the National Treasury could announce a new inflation target of 3%.

The implication here then, is that the SARB policy rate could have to stay higher for longer to secure a 3% rather than 4.5% CPI target. South African 10-year government bonds dropped 10bp on the news that inflation could be lower. The news was less welcome for South African equities, which were modestly down on the day.

The rand already enjoys quite a sizable real interest rate in the 4.5-5% area (with a policy rate at 7.50%), which may continue for a little longer if this new inflation target is brought in. As to whether USD/ZAR can sustain a break below 18.00, that is probably a function of Chinese growth prospects and global demand for South Africa's industrial commodities. We're still unsure on this front and have doubts that this move will extend to the 17.50/60 area.

Chris Turner

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

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