FX Daily: Reality check on US-China talk progress

Markets are anxiously awaiting today's update from Secretary Bessent on the content of initial US-China trade talks over the weekend. We think the market baseline is for tariffs to be cut to 60%, and there is room for disappointment. The so far unspectacular USD recovery will also face some data tests this week. EUR/USD remains around 3% overvalued

We think risks are slightly skewed to a weaker dollar today as Treasury Secretary Scott Bessent delivers his update on China

USD: Waiting on Bessent's update

US President Donald Trump described this weekend's US-China meetings in Switzerland as "very good" and said a "total reset" is being negotiated. Treasury Secretary Scott Bessent led the negotiations and said "substantial progress" has been made, and will share details today. Asset markets are again leaning on the optimistic side, and we think the baseline expectation is for an initial reduction in tariffs on China to 60%. Investors will weigh the new level of duties against the breadth of exemptions that are being discussed.

We have argued in recent weeks that the dollar likely requires a constant flow of positive news on trade de-escalation to keep recovering. The Trump administration has so far provided it, and while the dollar's recovery hasn't been nearly as spectacular as in equities, there is a strong sense that Trump's pragmatic shift on trade has trimmed the tail risks for the greenback. The dollar's solid momentum may be tested today as Bessent might fail to sell the progress in China negotiations to markets, and this week's economic calendar presents a few more obstacles for further USD gains.

The key one is inflation, released tomorrow. This April CPI print may start showing some signs of price hikes, but our economist notes this is likely too early for the tariff effect to show, given the lag between implementation, shipping the product, and arriving in a warehouse before appearing in stores and online. We expect core CPI at 0.3% month-on-month, in line with consensus. A similar figure should show for April's core PPI later this week, ultimately pointing to some lingering pressure on the Federal Reserve's preferred core PCE measure, but unlikely enough to trigger alarm bells for the central bank.

But what would happen to the dollar if inflation surprises on the hot side, showing an earlier than expected tariff impact? In most other conditions, the reaction would be USD-positive, but we are not sure in this case. Markets have already trimmed Fed easing expectations to just 62bp by year-end, with a first cut only in September. The room for further hawkish repricing is limited, and a hot CPI/PPI combination may simply raise the stagflationary risk, potentially harming the dollar in the near term.

Alongside retail sales, which might only prove strong on the back of some pre-tariff spending ramping up, markets will remain quite attentive to Fedspeak too this week. So far, some FOMC members have pointed to the tariffs' temporary nature as an inflation driver, but no strong dovish dissent to Chair Jerome Powell's cautious tone has emerged. Both the Fed and markets are in wait-and-see mode, on trade policy as much as on data. The former looks set to improve further, but the latter may deteriorate rapidly.

The dollar should continue to be pulled by these conflicting forces, and risks are starting to look finely balanced in both directions, looking a few weeks ahead. At the start of this week, scrutiny on the actual progress in US-China negotiations may lead to a softening of dollar momentum, but some decent support may start to form around 100.0 in DXY.

Francesco Pesole

EUR: Still quite overvalued

EUR/USD briefly printed below the 1.120 support in early trading. Should Bessent feed markets with convincing headlines on US-China talks today, a decisive break lower looks on the cards. The pair is trading 3% off its 21 April peak, but remains around 3% overvalued according to our short-term fair value model. That misvaluation is largely justified by the short-term rate differentials, which continue to heavily favour the dollar. The current EUR/USD two-year swap rate spread of -170bp coincided with EUR/USD trading around 1.06 or below before Liberation Day. While it's clear that spread is not the main driving force in current FX trading, further material de-escalations in trade wars and signs of resilience among US consumers despite tariffs can compress that risk premium further.

As mentioned in the USD section, we think risks are slightly skewed to a weaker dollar today as Bessent delivers his update on China. That may help strengthen the EUR/USD support around 1.12 while awaiting new trade and macro developments from the US. Anything happening in the eurozone on the macro side remains a secondary driver, although the ZEW surveys tomorrow can have some FX impact.

Geopolitical developments are also being monitored this week, although markets have now shown some reticence towards pricing in optimistic scenarios on Russia-Ukraine peace talks until some material progress is made. Trump has ramped up pressure on Russia to agree to a 30-day truce, and Ukrainian President Volodymyr Zelenskyy said he'll be "waiting for" Putin in Turkey on Thursday. A breakthrough in peace negotiations will be beneficial for EUR/USD, but the extent of the impact will be highly dependent on the market's assessment of the sustainability of any truce. There is a tangible chance markets will lean on the cautious side here.

Francesco Pesole

GBP: The strongest story in G10?

This will be a busy week in the UK data calendar. On Tuesday, we'll get the latest jobs figures. The job market is cooling but not significantly weakening after recent tax hikes. Last month's payroll drop might be revised up, and while unemployment is expected to rise, the figures have known reliability issues. Crucially, wage growth should slow, easing pay pressures.

On Thursday, the first-quarter GDP report will be released. February's GDP surged by 0.5%, and despite a potential pullback in March, the first quarter should show solid growth. This is partly due to volatile manufacturing numbers. The second quarter will likely be more subdued, but overall growth should be supported by government spending.

The pound has received support from an improved trade picture for the UK (i.e., deals with the US and India and upcoming negotiations with the EU) as well as from a hawkish-leaning Bank of England. Positioning imbalances, improved risk sentiment, and the upcoming EU-UK summit on 19 May may well keep EUR/GBP pressure, with a break below 0.840 now appearing increasingly likely.

Francesco Pesole

CEE: Not much rest after a busy week

We've just had one of the busiest weeks in the CEE region this year, but this week also has a lot to offer. Today, we will see the Czech National Bank's meeting with analysts, where the details of the new forecast will be discussed. Here, we could potentially hear more on the central bank's next steps.

Tomorrow sees the release of April inflation in Romania (up from 4.9% to 5.2% year-on-year) and final numbers in the Czech Republic, which we expect will show a stronger core versus the lower-than-expected headline rate last week.

On Thursday, we will see flash first-quarter GDP numbers in Poland and Romania. In both cases, we expect rather stagnant growth from the previous quarter. Poland will also release its final April inflation numbers, including core inflation, on Friday.

The National Bank of Romania meeting is likely to be of most interest this week. We expect rates to remain unchanged at 6.50%. However, the market will be looking for some commentary on the current situation and FX.

Last week changed some of our views that had worked for some time. The National Bank of Poland was more hawkish, while the CNB was more dovish relative to our expectations. PLN/CZK hit its bottom, and we saw some bounce on Friday. While EUR/CZK looks fair to us at current levels (and there is probably still some downside), the EUR/PLN move is too much. We believe the hawkish rates repricing points more to levels around 4.260. EUR/RON closed unchanged for the second day in a row, and the market saw some relief in forwards and bonds on Friday. Still, we don't believe this is the end of the story, with several events still on the table, including the second round of the presidential election next weekend.

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