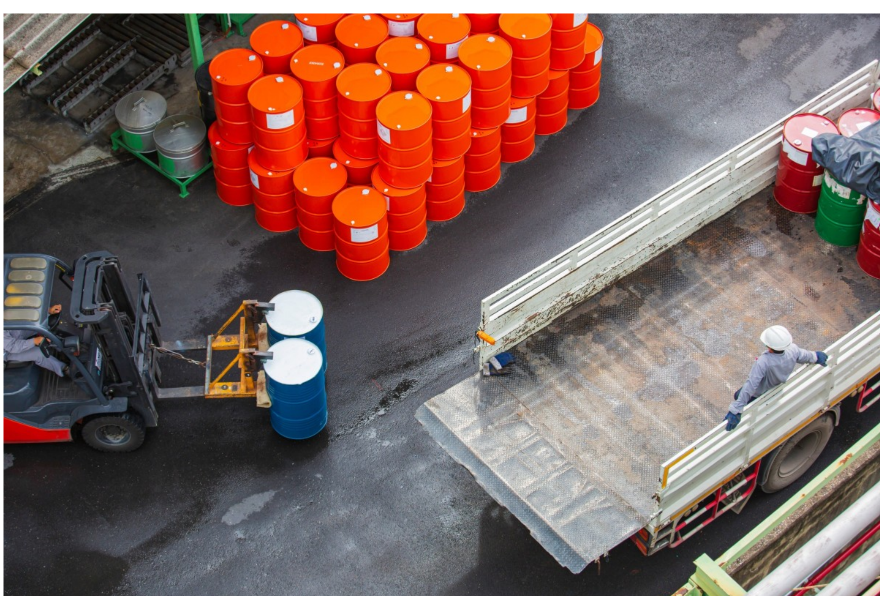
FX Daily: Remarkable resilience of risk assets

Investors have jumped on the news of 'great progress' in US-Iran negotiations, buying risk assets and selling the dollar. This is a far cry from the view that the oil market was close to a 'tipping point' which could trigger a non-linear spike in crude. It is too early to sound the all-clear in this crisis, but the USD can explore the downside



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USD: Risk on, dollar off

It seems equity investors are still looking to put money to work and are jumping on positive-sounding news from the Gulf. The reaction to the pause of 'Project Freedom' looks a little overblown, though attention is also turning to Iran's recent shuttle diplomacy, with its foreign minister visiting Russia and China in recent days. The bullish view here is that President Trump wants a deal before visiting President Xi on 14-15 May, and China may be bringing pressure to bear on Iran.

The prospect of a permanent peace deal remains highly uncertain, however, and oil looks set to remain very volatile. Here, the focus in energy markets is whether a tipping point is reached over the next month. The story would be whether oil inventories are drawn down so much that a bidding war erupts for the ever-scarcer supply. This could lead to a non-linear jump in oil prices.

Given the inventory story is going to gain greater attention now, the focus today will be on the 1630CET release of the US EIA weekly oil inventory numbers. A 2.4m barrel drawdown is expected after a 6.2m fall last week. Any much higher drawdown than expected could send oil sharply higher again.

Yet this window of optimism on a peace deal has allowed money to flow back into equities – driven by the underlying conviction that the tech sector AI buildout will endure. Overnight, Asian equities performed very well. The standout has been Korea's Kospi, where news of greater foreign access to local equity markets has powered the Kospi to a 7% gain and lifted the beleaguered won. Chinese equities have also been doing well, and some better April PMI numbers are helping to drive USD/CNY to the lows of the year, near 6.81. This better EM environment is typically a dollar negative, as it was in January and February when EM was witnessing heavy portfolio inflows. Looking at ETF flows data, it seems that investors have paused and not reversed their inflows into EM since the Gulf crisis erupted – potentially showing a conviction call.

Add in what could have been another round of Bank of Japan dollar selling in early Europe and the dollar opens offered. Whether it falls much further today depends on the path of oil (headlines and inventory data) plus the release of the monthly US ADP jobs data. A healthy +120k gain is expected in April. Any big miss could weigh on the dollar.

Given the uncertainty in the Gulf, it looks dangerous to be chasing the dollar a lot lower from current levels and range support at 97.65/75 in DXY may hold again. Yet we have to acknowledge the enduring pro-risk/$ negative undercurrent.

Chris Turner

EUR: The euro has been underperforming

Looking at the performance of the euro on the crosses, e.g. EUR/GBP and EUR/CHF, one could argue that the euro has been a relative underperformer. Here, the eurozone economic data has surprised negatively on the downside for the last two months as higher energy prices have weighed. Nonetheless, EUR/USD is getting a slight bid from the pro-risk mood in the market and the conviction view that the ECB will deliver a precautionary rate hike in June. Given very elevated inflation expectations – e.g. 3.03% derived from the two-year inflation swap – the euro will need to see the ECB follow through with that hike. Failure to do so and a decline in real interest rates would hurt the euro.

Away from the Gulf and energy markets, the focus today will be on the ECB's wage tracker and the April PPI data. The last release for the former had wages expected to grow at 2.6% in 4Q 2026. Any increase here could prove euro-positive in that it would give the ECB more cause to hike.

We are not convinced EUR/USD needs to trade up to and above 1.18 just yet and would not completely rule out EUR/USD finding its way back to 1.1700 again.

Chris Turner

GBP: The sterling conundrum

There has been much attention on the UK Gilt market this week, where Gilt yields have traded up to multi-year highs ahead of local elections on Thursday. Our rates strategy team has some doubts that the Gilt sell-off is being driven by the local election story, given that the UK swap

spread (Gilt yields versus GBP swaps) has been relatively stable. That could explain why sterling has been doing so well even as Gilts sell off.

If that is the case, then both Gilts and sterling do face some downside risks if Thursday's UK local election prompts a serious challenge to the current leadership of the UK Labour Party.

EUR/GBP has good support down at 0.8600/8610, which we expect to hold.

Chris Turner

BRL: One of our EM favourites

As above, it seems like investors have an enduring demand for risk and some exposure to emerging markets. Latam as a region is seen as an outperformer, especially those with some independent access to energy. Here, Brazil is a net energy exporter and its terms of trade have risen sharply since the outbreak of hostility in the Middle East. Brazilian equity markets have been flying this year and with the local central bank expected to cut rates 100bp this year, local currency bonds could do well if conditions calm down.

USD/BRL has broken clear of 5.00 now. With implied yields in excess of 13%, we would expect the BRL to remain at the forefront of interest in emerging markets. The key threat is probably a political one should President Lula consider unfunded fiscal giveaways ahead of the October elections. However, investors look happy to bear that risk and USD/BRL losses could extend into the 4.80/85 area should the path to peace in the Middle East become any clearer.

Chris Turner

Author

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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

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