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FX

FX Daily: Risk on weighs on dollar, but caution warranted

Strong gains in risk assets around the globe are putting pressure on the dollar. We are not big fans of chasing it lower just yet, though. US interest rates are stable rather than falling, and there is little evidence so far of foreigners selling long-term US assets or increasing dollar hedge ratios. For today, look out for ECB speakers and minutes



Barring some negative headlines out of the Middle East, risk assets should stay mildly bid and the dollar mildly offered today

➔ USD: Case for a much weaker dollar has yet to be made

Risk assets are recovering well as investors continue to position for de-escalation in the Middle East. The return to equity markets and to pro-growth and higher-yielding EM currencies has led to a broadly softer dollar. However, we question whether conditions are right for a sustained dollar decline just yet, when assessing factors like Fed policy, global growth and any evidence that foreign investors are quietly leaving US asset markets or increasing dollar hedge ratios.

On the Fed, last night saw the release of the [Beige Book](#) ahead of the 29 April FOMC meeting. This showed economic activity flat to modestly expanding, with the K-shaped dynamic in full swing. Lower-income households were feeling the strain, while higher-income spending

remained resilient. The labour market seemed to be holding up well, while on pricing, the survey showed that input costs were rising more quickly than selling prices. This was generating margin compression. In all, it points to a Fed comfortable with the policy rate at 3.75%, where neither the labour market is deteriorating nor are second-round inflation effects growing. The case for renewed Fed easing has yet to be made, although the whole world will be glued to Kevin Warsh's confirmation hearing next Tuesday for any dovish plans.

On the subject of global growth, it is tough to see markets overlooking the headwinds which have been created over the last month. Energy prices look higher on a sustained basis (though this is not as large a shock as 2022), while interest rates, unlike currencies, have notably failed to retrace any of their moves in March. These tighter financial conditions have to prove a brake on global growth, which will likely emerge in hard data over the coming months.

As to the subject of volatile policymaking out of Washington causing investors to reduce concentration risk in US asset markets or increase dollar hedge ratios, evidence is scant. Last night's release of US TIC data for February showed the foreign private sector buying \$147bn of US long-term securities in February, the highest since last September. Equally, we have an article [here](#) suggesting that instead of causing the dollar sell-off during January/February's Venezuela/Greenland news, the European buy-side used the cheaper dollar to decrease their dollar hedge ratios.

Barring some negative headlines out of the Middle East, risk assets should stay mildly bid and the dollar mildly offered today, but we don't see conditions in place for DXY to make an immediate return to the lows of the year at 96. We have a couple of Fed speakers today and the weekly initial claims data, though these look unlikely to move markets.

Chris Turner

➔ **EUR: ECB keeping its options open**

EUR/USD price action has been impressive in that it has retraced the entirety of its losses in March. The good news for EUR/USD bulls is that the pricing of an April ECB hike has quietly evaporated without weighing too heavily on the euro. A June hike remains fully priced and we suspect the ECB will need to deliver this for EUR/USD to stay supported this summer.

Today, we will receive the minutes of the 19 March ECB meeting and then hear from a host of ECB speakers in Washington. The prevailing view at present is that the ECB sees the current situation somewhere between its baseline and adverse scenario, meaning that it has to keep the possibility of a rate hike on the table.

We have been surprised by how quickly EUR/USD has made it all the way back to 1.18. We are not fans of chasing it higher from here and feel it could easily correct back to 1.1700 on any adverse news.

Chris Turner

➔ **JPY: Bold action threatened, but not a game-changer**

US and Japanese currency officials have been meeting in Washington and suggestions of closer co-operation are keeping investors wary of intervention. Yet barring a big drop in energy prices from here (unlikely) or much lower US interest rates (again not clear), it looks like the verbal intervention from the Japanese is an exercise in containing USD/JPY upside.

However, at ING, we think the current probability (20%) of a Bank of Japan rate hike on 28 April is too low. Should it be delivered, that could help cement the top of the USD/JPY range at 160. But the conditions for a sustained drop in USD/JPY have yet to be met and we favour a continued 155-160 range for the rest of the quarter.

Chris Turner

⬆️ **BRL: The real has had a good crisis**

If FX volatility starts to settle again, investors will increasingly return to the carry trade. Here, the Brazilian real, with its 12-13% per annum implied yields available through the NDF market, will remain popular. Brazil is also a net energy exporter and the prospect of a sustained easing cycle (175bp of cuts currently priced over the next 12 months) will keep the interest in Brazilian local currency bonds.

The real has also been benefiting from opinion polls showing that Flavio Bolsonaro would defeat President Lula in a second round run-off. Presidential elections take place in October this year. The Brazilian real does not look particularly expensive on a real, trade-weighted basis, and USD/BRL could continue its strong run sub-5.00 should global conditions allow.

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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