

FX Daily: Risk re-assessment?

Jitters in European banks on Friday fuelled a recovery in the dollar against pro-cyclical European FX. Markets are once again forced to re-assess the risks in the two epicentres of the banking crisis (US and Europe), and that will drive much of the G10 FX swings this week. Still, monetary policy differentials seem to point more clearly to a higher EUR/USD



📉 USD: Dollar support comes from Europe

The dollar regained some ground in the past two trading sessions, largely thanks to developments overseas (in Europe) rather than any material improvement in US-related drivers. This safe-haven demand is mostly related to banking stress on the other side of the Atlantic. As widely discussed last week, the Federal Reserve has likely failed to offer clear enough communication and this leaves rate expectations – and by extension, the dollar – very strictly tied to US financial stress.

Markets have turned increasingly doubtful that the Fed will be able to tighten policy any further, and have simultaneously speculated on an early start to the easing cycle. Fed funds futures currently price in only a 30% chance of a rate hike in May while fully pricing in a 25bp cut in July, and a total of 80bp of easing by year-end.

The variables that currently drive that pricing for Fed hikes/cuts are the following: a) developments

with US regional banks; b) the stance of the US Treasury on extending deposit insurance; c) Fedspeak. On the first two – interconnected – points, the newsflow may still be rather volatile. The US regional banking crisis has not gone away, with deposits either leaving the banking system altogether or being moved to larger institutions, and there are still multiple banks being highly scrutinised and likely to hit the headlines and market sentiment at any time.

On the Fedspeak, we heard from Neel Kashkari over the weekend. While being normally one of the most hawkish voices in the FOMC, he sounded quite alarmed about the risks of a credit crunch hitting the economy and generating a deeper economic slump. In a week without much exciting data in the US – consumer confidence and PCE are the only highlights – Fed speakers will be in focus.

From an FX perspective, the resurgence in banking stress in Europe forces some softening of our bearish dollar view for the moment, at least until we can get more clarity on the stability of the EU banking sector. Still, we continue to see the Fed as mostly carrying downside risks for the greenback, as the lack of clear communication leaves the door open for dovish speculation as the US regional crisis remains unresolved and is keeping the monetary policy outlook in the US in stark contrast (for now) to that of most European central banks. On balance, we see more balanced risks for DXY this week, but volatility may remain elevated, and if anything our preference remains for a higher EUR/USD.

Francesco Pesole

EUR: Reassessing risks?

A jump in markets' perceived risk on Deutsche Bank and other European lenders last Friday brought financial stress back to Europe after a prolonged period of tentative calm as markets digested the fallout from the Credit Suisse takeover. Futures today point to a rebound in European equities, possibly suggesting last week's concerns may have been overdone. At the same time, we have learned how market conditions can change extremely rapidly in the current environment, and Friday's turmoil suggests that confidence among European bank bondholders is far from fully restored after the Credit Suisse saga.

While our general view favours a higher EUR/USD on the back of monetary policy divergence, last Friday brought a warning not to jump to the conclusion that this banking turmoil is turning into a US-only story – and therefore into a straight-line bullish EUR/USD. Still, a move to 1.10 in the coming weeks remains a very tangible possibility. For this week, re-testing 1.0900 would already be a very welcome sign for EUR/USD bulls.

Today's Ifo reading in Germany is the main highlight of the week until Friday's CPI flash estimates in the eurozone. In the meantime, the focus will be on the many European Central Bank speakers.

Francesco Pesole

GBP: All eyes on Bailey

Domestic drivers for the pound are concentrated at the front this week. Today and tomorrow, we'll hear from Bank of England Governor Andrew Bailey, and his words will be weighed very carefully by markets given that the March BoE meeting did not include a press conference. He will speak today at a BoE event and testify tomorrow to the Parliament's Treasury Committee about the

Silicon Valley Bank collapse. Markets are already pricing in another hike by the summer, so the bar for a hawkish surprise to lift GBP does seem relatively high. Our economists do not expect any more hikes.

With virtually nothing to highlight on the data side, GBP may be moved by Bailey's words but should rapidly default to being driven by external factors. Essentially, GBP/USD is a USD story and EUR/GBP is a EUR story. We still think cable can reach 1.2500 this quarter, and that the EUR looks marginally more attractive than GBP, and EUR/GBP should move back to 0.8900.

Francesco Pesole

CEE: Hawks return to stage

For the first time since the recent global turmoil, attention returns to the region this week. Two new MPCs are scheduled to hold hearings today in Hungary's parliamentary economic committee. A meeting of the [National Bank of Hungary](#) is scheduled for the day after. In line with surveys, we expect rates to remain unchanged and central banks to maintain a hawkish tone, especially with the recent forint sell-off and weaker levels. In addition, Friday marks the end of the non-binding deadline for the approval of the legislative package to unlock some of the EU money. Thus, some headlines on this topic can be expected in the coming days. We expect the government to find an agreement with the European Commission (EC), but the EC's first reactions to Hungary's progress may be negative, bringing uncertainty to local markets.

The [Czech National Bank](#) (CNB) will meet on Wednesday, and we expect unchanged rates and a hawkish tone here as well. As in Hungary, weaker FX and still too high inflation do not allow the CNB to ease up on rhetoric despite dovish expectations priced in by the markets.

March inflation in Poland will be released on Friday and should show the first slowdown since the February peak. The market expects a drop from 18.4% to 16.1% however we expect a lower number around 15.5% year-on-year.

No doubt the FX market in the region will again be driven mainly by the global narrative. However, we should see some local stories as well. The main focus will be on the Hungarian forint, which may find it very hard to find its way between the possible dovish worldview of new MPCs, the hawkish NBH and the mixed headlines coming from the EU story. Moreover, the forint maintains the highest beta to global news, which may result in high volatility this week. We remain bullish on the forint and should head back below 380 EUR/HUF, however this week may bring more pain on the way lower. We see a much clearer picture for the Czech koruna, which should be supported by the CNB's hawkish tone. The market is currently pricing in a roughly 130bp rate cut by the end of the year and the CNB meeting should be a catalyst to reassess these expectations. If the global story allows it, we should see the koruna below 23.50 EUR/CZK.

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