

Article | 31 March 2026

FX

FX Daily: Searching for the off-ramp

Equities have found support in a report that the US may be willing to end its military activities in Iran even if it leaves the Strait of Hormuz closed. That will be scant solace for the global economy unless a pathway to lower energy prices becomes clearer. With US light crude now over \$100/bl, we could hear more conciliatory US talk and the \$ could soften



Second-guessing White House policy is risky business at the moment

➔ **USD: \$100/bl light crude and a steady Fed are helping risk assets**

Trying to second-guess White House policy remains a hazardous occupation, but this Tuesday morning it seems investors are minded to look out for any signs of de-escalation. Helping those views has been a *Wall Street Journal* report that President Trump is willing to end the war without reopening the Strait of Hormuz. With US light crude now trading above \$100/bl – a sensitive level for the White House, apparently – the market will be on the lookout for any softer US rhetoric today.

Of course, the Iranians are operating off a completely different playbook and will do their utmost to maintain maximum economic leverage by keeping energy prices as high as possible – hence the attack on a Kuwaiti supertanker in Dubai today. For what it is worth, traders on Polymarket today price a 60% chance of US boots on the ground by the end of April. This

compares to a 74% chance priced late last week.

Perhaps also helping risk markets have been some comments from the Fed over the last 24 hours. Fed Chair Jerome Powell yesterday sounded quite relaxed and said that medium-term inflation expectations were well-anchored. Clearly, there was no fuel to the view of early Fed hikes here, and money markets switched back towards pricing a Fed cut by the end of the year. This provided some good support to the bond market.

US data should be mixed news for the dollar today. JOLTS job opening data is for February and may be reasonably robust. Consumer confidence data is for March, however, and is expected to head back towards the lows seen last April. The latter data can help to keep the Fed mildly dovish and the White House looking for an off-ramp in the Middle East.

The above could mean a slightly softer day for the dollar, where DXY is currently pressing the top of a nine-month trading range at 100.50. We should also look out for month-end fixing flows today. US equities have slightly outperformed overseas equities this month, meaning there could be some dollar selling coming through as the buy-side rebalances its portfolios. The same applies to fixed income, where US bonds have outperformed during the global sell-off this month.

Chris Turner

➔ **EUR: Short-dated rates come lower**

After a staggering 80bp spike this month, short-dated euro swap rates are now starting to turn a little lower. This is a global phenomenon as traders reassess whether central bankers will push ahead with rate hikes in economies operating with much more [spare capacity than in 2022](#). That said, the retracement in euro swap rates has been pretty modest so far. And in a piece we published [late last night](#), we made the case that the rise in nominal rates this month had barely offset the surge in inflation expectations because of the oil shock. And in fact, the two-year real swap differential has actually moved against EUR/USD. That could be tricky for the ECB if, as we expect, it refrains from a rate hike at the end of April and inflation expectations remain elevated. This could prove to be euro-negative.

For today, however, the focus will be on eurozone March inflation – expected at 2.6% year-on-year from 1.9% in February. Inflation across the region has not been quite as high as expected, and we could see the chance of an April ECB rate hike repriced a little lower from 50% currently.

EUR/USD has found some support in the 1.1440/70 area and could get a modest lift should we receive any further reports of de-escalation out of Washington today. And the soft US consumer confidence reading could trigger a move back to the 1.1550 area. But until energy is freely flowing in the Strait of Hormuz again, we doubt investors will return to long EUR/USD

positions with confidence.

Chris Turner

↑ **JPY: Starting to show some outperformance**

It was not a particularly bad day for risk assets yesterday, but the yen started to show some clear outperformance. Who knows if Japanese authorities will intervene to sell USD/JPY at 160 or leave it until 165, but what seems clearer is that there is a larger chance of the Bank of Japan hiking in April than there is for many other G10 central banks. Japan's starting point of heavily negative real interest rates means the Bank of Japan has some catching up to do.

Investors probably find it a little dangerous to go against this USD/JPY bull trend. After all, Korea now has to deal with USD/KRW at 1535 despite a huge domestic effort to prevent won weakness. Yet we have a growing bias that something like EUR/JPY could start to move lower, with an initial target at the February low of 180.80.

Chris Turner

↓ **PLN: Remains exposed to geopolitical turmoil**

In Poland, we will see inflation figures for March today, the first in the CEE region affected by higher global fuel prices. Higher gasoline and diesel prices alone pushed CPI up by more than 1pp versus February. Along with higher food price dynamics and slightly higher core inflation, in our forecast, it pushed headline inflation from 2.1% to 3.5% YoY, i.e. the upper bound of acceptable deviations from the 2.5% inflation target for the National Bank of Poland.

Market pricing has somehow stabilised in recent days at around three National Bank of Poland rate hikes in the one-year horizon, similar to the rest of CEE and ECB markets. However, the government's move to reduce VAT on fuel should shave some 0.5-0.9pp off April inflation, giving the central bank more room to avoid raising rates, which is also our forecast, unless the situation escalates further.

On the other hand, Polish government bonds remain the main underperformer within the region with an almost 100bp increase in 10y yield and asset spreads (ASW) widening above 100bp at the long end of the curve, well above CEE peers. One reason is probably heavy long positioning, especially from fast money. At the same time, however, hopes of NBP rate cuts have also evaporated and pressure is increasing on fiscal policy, where Poland already has the highest expected deficit within the EU this year. Combined with the government's actions, the curve is returning to steepening and EUR/PLN, which remains relatively stable, is gradually pushing towards 4.300. This should be a sufficient level to hold for now, however Poland remains significantly exposed in the current geopolitical turmoil, increasing the risk for FX as well.

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