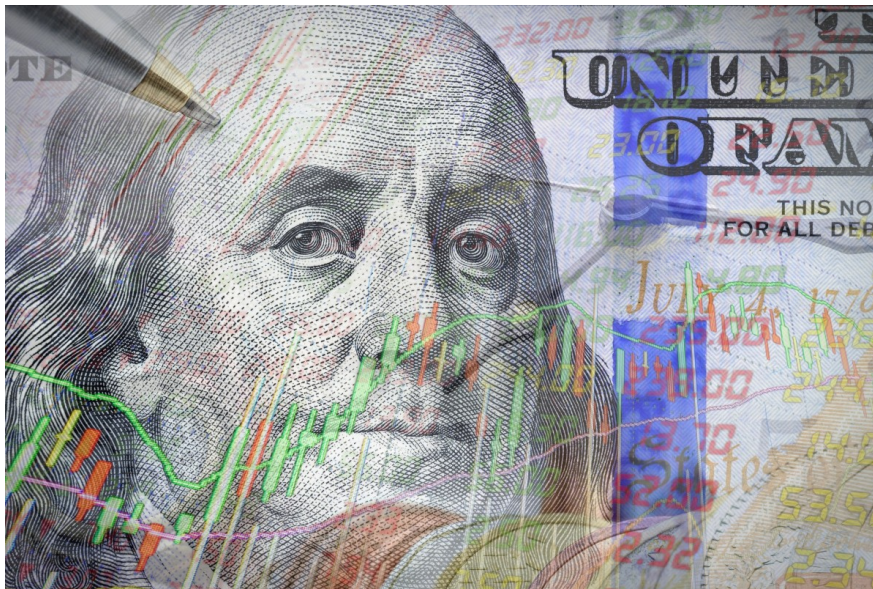


FX Daily: Slow disinflation, low volatility

Today's PPI and tomorrow's CPI figures will tell us whether the US has made further steps in the disinflation process, or if prices remain too sticky for the Federal Reserve to cut. The latter seems more likely, and a consensus call too – which could leave FX markets without much sense of direction and volatility still depressed



➔ USD: PPI, Powell and NFIB in focus today

The currency market is awaiting the next big move as the US calendar picks up. Since the weekend, we have seen a moderate risk-on bias in G10 FX, with the safe-haven CHF, JPY and dollar trailing pro-cyclical European currencies. This may suggest investors felt no urge to increase defensive positions ahead of US inflation figures today and tomorrow.

The CPI report will have a larger market impact, although we have seen the dollar moving on tier-two data lately, so today's PPI figures for April can be a big event for markets too. Expectations are for a 0.2% month-on-month core PPI print, which would match the March figure – when core CPI printed a hot 0.4% MoM. It's also worth noting that inflation expectations have been on the rise, with yesterday's New York Fed survey showing one-year expectations at a five-month high (3.3%) after the University of Michigan also reported a similar development.

While markets have taken stock of the seemingly cooling US jobs market, data this week may

indicate that the inflation picture remains more uncertain and still too hot for the Fed to revamp strong dovish communication. On the FedSpeak space, Chair Jerome Powell will participate in an event this afternoon, but major deviations from the recent policy tone does not seem too likely before inflation figures are published. On the data side, there is also the NFIB Small Business Optimism index to watch today, which has grown in relevance as a leading indicator recently.

The dollar has shown some tendency to asymmetrically bearish reactions to US data after the latest CPI print, so risks could look a bit skewed to the downside if one believes there are equal chances of an upside or downside surprise in inflation this week. In practice, inflation has mostly surprised on the upside recently and we suspect there are smaller chances of a lower print.

Consensus prints today and tomorrow may simply put off the whole inflation discussion by a few more weeks, and leave a market that has largely digested the “divergence” narrative (Fed vs. Europe) directionless for longer. A low-volatility environment favouring carry trades could be the norm for longer if this week’s data fails to offer a different story.

Francesco Pesole

➔ EUR: Converging growth stories?

The ZEW survey out of Germany is expected to show further improvements in sentiment today, even though the “current situation” index should remain deep into negative territory. If the notion of diverging monetary policy between the eurozone and the US is hardly new at this point, the one of slowly converging growth stories (US jobs slowing, eurozone outlook improving) may be preventing that kind of major rotation from EUR to USD that many had called for on the back of rate differentials last month.

Today, we’ll also hear from the European Central Bank’s Klaas Knot (speaking with Powell at the same event) and Isabel Schnabel. They are two hawkish members and we can probably expect some words of caution about future monetary easing plans beyond June.

EUR/USD will be moved by US data in the next couple of days. If we do not see substantial surprises, the pair will probably be able to consolidate further in the top end of its trading range and around the 1.0800 level.

Francesco Pesole

➔ GBP: Higher than expected wages but no game changer for BoE

The latest UK wage figures were a touch higher than expected, but this appears to be mainly linked to public sector pay. Private sector wage growth was more in line with what had been expected, and it's this that the Bank of England is paying closer attention to. That said, given that these figures have been more volatile recently, the Bank has indicated it is putting less weight on them than it was previously. Services inflation next week is ultimately what will make or break the June rate cut story (market currently pricing 50% chance). Meanwhile, the unemployment/employment figures are still believed to be highly unreliable and should be disregarded.

EUR/GBP is trading almost unchanged after the releases at 0.859 but indicates downward heading. Our view remains generally bullish on the pair, but admit that a substantial move higher may well

need to wait a bit longer and potentially only materialise in the summer, when we see markets pricing rate cuts beyond August more aggressively.

Francesco Pesole

👆 CEE: Surprisingly higher inflation as a reason to drop the negative bias for the CZK

This morning, inflation in Romania showed a surprise drop from 6.6% to 5.9% year-on-year, well below all estimates and its lowest level since September 2021. Later today, the current account numbers for Poland, the Czech Republic and Romania will be released. Two speakers are scheduled in Hungary in the morning, with the National Bank of Hungary's Deputy Governor Barnabás Virag and Minister Márton Nagy expected to speak at the same event.

Yesterday, the National Bank of Romania decided to leave rates unchanged despite market expectations. We see the press release following the decision yesterday as slightly hawkish but it is clear that recent developments at home and abroad have managed to push back the start of the cutting cycle. The inflation report will be released tomorrow, however it seems we will have to wait a little longer for the first rate cut in Romania. We expect the first rate cut in August.

In the Czech Republic, inflation surprised significantly yesterday by rising from 2.0% to 2.9% YoY. Food prices and fuel prices are the main reasons, but headline inflation is still above the Czech National Bank's forecast. In our view, this will lead to an even more hawkish tone from the CNB and a slowdown in rate cuts from a 50bp pace per meeting to 25bp, and there is a risk of a pause in our view.

EUR/CZK fell 0.5% after the inflation surprise, making the CZK the strongest since February when the CNB raised the pace of rate cuts to 50bp. This shift in the CNB story is therefore a reason for us to drop our negative bias for the CZK that we have had for the past weeks and we no longer expect a renewed weakening, given that the CZK may instead get more support from the CNB. Even so, we still see the CZK outpacing market rates probably due to heavy positioning. EUR/CZK should thus remain in the 24.80-90 band for now, in our view.

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