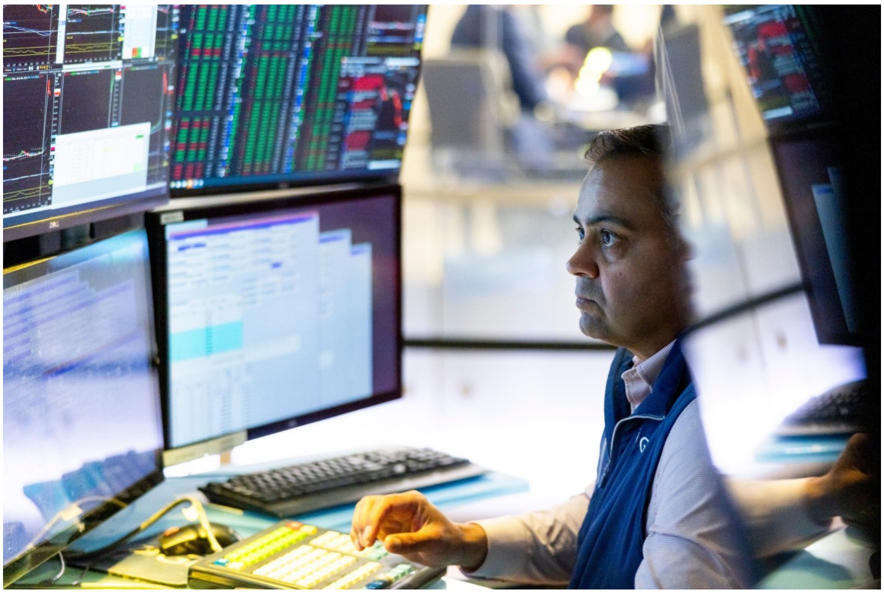
# FX Daily: Some calm returns to FX

Some calm is returning to FX markets after another day of trade-driven volatility. The 90-day pause in the US-China trade war has allowed the dollar to recoup some losses, although we doubt it needs to rally a lot more from current levels. For today, another sticky US core inflation reading at 0.3% MoM should keep US rates and the dollar supported



A trader at the New York Stock Exchange. Markets have calmed since yesterday's news that the US and China agreed to drastically cut reciprocal tariffs

## USD: April CPI print should keep the dollar supported

FX markets are settling down after a lively Monday. As discussed in our reaction piece here, it made sense for the Japanese yen and Swiss franc to sell off the hardest as Washington policy was re-appraised. Here, the 90-day truce is very much a tick in the box of 'pragmatic' policy as opposed to ideological views that imports (especially from China) were inherently a policy failure.

Today, the release of US CPI data for April highlights one aspect of the impact of April's tariffs on the US economy. How much of the jump in tariffs on Chinese goods got passed onto the US consumer? Or did US importers try to absorb those tariffs in their margins or abandon imports altogether? Our Greater China economist, Lynn Song, made a great point in his review of China's April trade data that exports to the US had held up reasonably well, suggesting the tariff pain would sit with US businesses and the consumer. And our US economist, James Knightley, thinks it might take until June for those tariffs to show up in US inflation data.

That said, today's April core CPI data is still expected at a sticky 0.3% month-on-month and should feed into the narrative that the Fed is in no hurry to cut rates. In fact, this month the terminal rate for the Fed's easing cycle has been repriced to 3.50% from 3.00%. In particular, the market has shifted the pricing for the first Fed cut to September, which we still think could be a 50bp cut to kickstart another mini easing cycle. Today, we'll also see April's US small business NFIB optimism index. Another drop in confidence is expected here, but this may not be a market mover in light of yesterday's US-China detente.

As to the dollar, the view that Washington seeks to pull back from an act of self-harm has sent equity markets soaring and the US 10-year swap spread (a credit gauge for the US government) has narrowed a little. Very compelling stories for asset re-allocation away from the US and the dollar may have to be paused temporarily – at least until we see how much this uncertainty has hit the hard data.

DXY broke through strong resistance at 100.80 yesterday (now support) and may well be on its way to the 102.60 area. However, we see this is a bear market correction rather than the start of a major dollar rally, and suspect that both the public and private sectors will want to cut their share in US allocations/raise dollar hedge ratios into any 2-3% dollar rally from current levels. We discuss some of these themes in our Unipolar Disorder report.

*Chris Turner*

## EUR: Cheaper levels

At some points over the last six weeks, it felt like there was no point trying to pick a top in EUR/USD as overwhelming bearish sentiment on the dollar dominated. But that EUR/USD move to 1.15/16 did mark an extreme 5/6% over-valuation on our short-term financial fair value models and served as a reminder that there are some limits after all.

For now, it looks as though EUR/USD has completed a first leg in a sequence of what could be a multi-year bull trend. We imagine this current corrective dip will find good buyers in the 1.1030/50 area, with outside risk to 1.0850. But this week's decline makes us feel more comfortable about our year-end target of 1.13, which otherwise had looked too conservative.

Some potential challenges to the dollar later this week could be Thursday's US retail sales data for April and Friday's TIC data for March – the latter showing whether foreign investors (including central banks) have been leaving US asset markets. EUR/USD will also be interested in whether all three leaders of the US, Russia and Ukraine make it to Istanbul this Thursday.

For today, the European calendar has German ZEW expectations – consensus expects a recovery here – plus a couple of ECB speakers. We have a slight EUR/USD bias to 1.1030/50 today.

*Chris Turner*

## GBP: Holding onto gains

Today's UK labour market data has had no discernible impact on sterling. Private sector pay growth is starting to slow, but last month's large fall in payrolled employees has been revised up (to -47k from -78k) as our UK economist, James Smith, had been expecting. Far more interesting for the Bank of England will be next week's April CPI services release.

Before all that, however, we have the UK-EU summit on 19 May. Expect sterling to stay bid ahead of that – potentially even seeing EUR/GBP break below 0.84.

*Chris Turner*

## CEE: Not all good news supports stronger FX

April inflation in Romania was released this morning, the last figure in the CEE region. The headline number was steady at 4.9% YoY, on market expectations. However, given the current market volatility, the central bank will pay little attention to this number. On Friday, the National Bank of Romania will meet, and we expect rates to be unchanged, but the focus will be more on EUR/RON and the market situation.

Later this morning, we will also see the final inflation numbers in the Czech Republic. Last week's headline number surprised significantly to the downside with a drop from 2.7% to 1.8% YoY, below market and central bank expectations. However, the main drivers were food and energy. Today we will see a full breakdown plus core inflation, which should suggest a more hawkish case for the central bank.

Although global sentiment turned positive after yesterday's trade headlines, not everything is positive for CEE FX. The combination of a strong USD and a sell-off in EUR rates outperforming CEE markets is putting local FX under pressure. At the same time, we see some divergence of CEE from European equity indices, which has been a good indicator for HUF, in particular, this year.

The market has also been building some long positions in CEE in recent weeks, which may now be tested by a stronger USD. We see EUR/CZK heading above 25.00 in the coming days, indicated by yesterday's outperformance of CZK rates vs EUR. EUR/PLN went too low in our view after the National Bank of Poland's meeting last week, and yesterday's market reaction opens the way back to 4.260. EUR/HUF is breaking away from global drivers and may test 406 upside again today.

*Frantisek Taborsky*

### Author

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

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

**Francesco Pesole**
FX Strategist
francesco.pesole@ing.com

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