

FX Daily: A welcome respite for FX markets

FX markets are calming a little after a riotous month. When the dust settles, however, we are still left with a Fed on course to tighten rates above 3% into next year and the commodity shock from the war in Ukraine. Commodity currencies could now enjoy something of a bounce-back, but expect the dollar to hold onto large parts of its gains



USD: April retail sales should keep dollar supported

After quite a month in financial markets which saw global equity markets fall 15% and USD/CNY spike 6%, it seems like we are entering a period of consolidation. At the epicentre of that unease has been China, where lockdowns have seen Chinese and global growth forecasts cut. The lockdown strategy by Chinese authorities seems unlikely to change anytime soon, but there is some very short-term optimism that the residents and workers of Shanghai might be released after three days without a new Covid case. That news has seen USD/CNY and USD/CNH start to stabilise and one-month USD/CNH traded volatility drop to 6.3% from levels above 8% only a week ago.

Given that the sharp adjustment lower in the renminbi had hit emerging market FX and commodity currencies in general, while helping the dollar, one could now expect a very short-term reversal of those trades. Two currencies we would favour in this temporary recovery would be the Canadian dollar (CAD) and the Norwegian krona (NOK). Both have been hit hard by the renminbi-inspired sell-off, but both continue to enjoy strong terms of trade gains with Brent still trading above \$110/bl. USD/CAD can continue this correction to 1.2715/50, while USD/NOK could correct a little further to the 9.60 area.

However, pockets of recovery in oversold commodity currencies should not be confused for a major turnaround in the dollar. Our debt strategy team still calls for some further bearish steepening of the US yield curve and the US 10-year real yield pushing to +100bp over coming months - from +20bp today. This will continue to pose a challenge for equity and credit markets and we would view this week's recovery in both as a pause in a bear trend rather than a meaningful reversal.

Also, today look out for US April retail sales and industrial production, [both of which are expected to come in strong](#). We will also hear from Federal Reserve hawk James Bullard at 14CET and Chair Jerome Powell at 20CET. It seems too early in the tightening cycle for the Fed to be fighting market expectations of tightening and the dollar could in fact be a little stronger tomorrow after Powell's remarks tonight. But for today's session, we favour consolidation and a few recovery stories.

DXY could correct a little lower today, but the 103.40 area could be too far.

➔ EUR: Short term bounce

Some temporary calming in Chinese tension has allowed EUR/USD a short-term reprieve. Today looks as good a day as any for an oversold bounce in EUR/USD, which could carry it as high as 1.0550. Interestingly, expectations for European Central Bank hikes are still creeping higher - where 91bp of tightening is priced in compared to 85bp last week. The ECB managing expectations of a 100bp rate hike this year may be what it takes to deliver some temporary stability to EUR/USD - even though we remain in a powerful downtrend.

In terms of eurozone data today, look for 1Q22 GDP to be confirmed at 0.2% quarter-on-quarter.

➔ GBP: Confounding the bears

As we have seen so often over recent years, writing off sterling should come with a health warning. Having touched 0.86 last week, EUR/GBP is already back to 0.8450. This morning we have just seen a strong set of UK employment/wage data which will be a tick in the 'continue tightening' side of the Bank of England's policy calculus ledger. The BoE policy rate is still priced above 2.00% and today's data is supportive.

It has also been interesting to see sterling running with a high correlation (along with commodity currencies) against the renminbi. The current short-term recovery of the latter can see GBP/USD recover a little, where a move through 1.2400/2410 could see a brief spike into the 1.2500/2550 area. Those could be some of the best cable levels for some time.

Sterling seems to be ignoring Northern Ireland politics at the moment - perhaps because Conservative backbenchers and also US politicians are leaning on the UK government not to go ahead with unilateral actions on the Northern Ireland protocol. EUR/GBP to remain gently offered,

but 0.8430/0.8400 may well be the best sterling levels to be seen for a while.

NOK: Primed for a recovery

The Norwegian krone goes through episodic sharp declines at times of market stress but usually reclaims those losses when conditions settle. As above, we see a temporary reprieve for risk assets, which will allow investors to focus on one of the enduring impacts of the war in Ukraine - higher energy prices. Having rallied 8% over the last month, we would not be surprised to see EUR/NOK correcting lower in a move that could extend back to 10.00.

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