

## FX Daily: Surprisingly low volatility keeps carry trade dominant

Despite the unresolved crisis in the Middle East and inflation spreading around the globe, FX markets remain very relaxed. Traded volatility levels are towards the lower end of five-year ranges. If currencies are not going anywhere, investors will continue to park funds in those offering higher yields. Hence, the ongoing demand for the AUD and NOK



Sterling finally saw some independent weakness yesterday as Westminster politics moved front and centre

### ➔ USD: Fed pricing shifts more hawkishly

One dominant observation in FX markets right now is that traded volatility is surprisingly low. Despite the prospects of a stagflationary oil shock derailing the global economy, FX volatility levels are not far from their five-year lows. That probably has a lot to do with equity markets, where the AI super-cycle continues to dominate, and we are noting how equity markets are playing a more dominant role in FX pricing than either rate differentials or oil prices. With summer fast approaching, it seems like it will take a lot to shake the market out of its low volatility mindset and will keep the G10 high yielders of the Australian dollar and Norwegian krone in demand as carry trade strategies remain popular. These currencies also benefit from commodity exposure and have seen their terms of trade rise since the Iranian conflict began.

Barring a sharp fall in equity markets, modest moves in currencies will continue to be driven by the next big move in oil prices and how central banks (including the Fed) react to higher inflation. On the former, Brent oil is steady near \$106/bl. Look out today for monthly oil market reports from the IEA and OPEC. Later today, we will also see the weekly EIA oil inventory data, where any larger drawdown than the 2 million barrels expected could drive oil prices higher again.

For the Fed, we note that yesterday's above-consensus April CPI numbers have pushed 1-month OIS rates priced one year forward to the highest levels since early 2025. Most are concluding that Kevin Warsh, who should be confirmed as the new Fed Chair today, will have little room to get his dovish message across in the current environment. Today's input to the Fed story will be the April PPI numbers and a speech by the Boston Fed's Susan Collins, seen as being towards the more hawkish end of the spectrum.

With reasonably high deposit rates of 3.65% (one week) and seen as a hedge if oil prices spike or equities turn south, the dollar should stay reasonably in demand for the time being. Given that the DXY dollar index is weighted heavily to European currencies and the yen, DXY can continue to trade in a 98.00-99.00 range. Against emerging currencies, the dollar could come a little weaker in anticipation of some warm words and commercial deals resulting from President Trump's forthcoming trip to China.

*Chris Turner*

## ➔ EUR: Low vol environment

EUR/USD three-month traded volatility is now 5.7%. That is more than 1% below realised volatility and not far from the 5.2/5.3% lower end of the range for traded volatility seen over the last five years. That does not mean that a new trend cannot occur, but when looking at the relatively flat risk reversal (the price of a euro call over an equivalent euro put), the conclusion is more range-bound EUR/USD trading.

Given that we see slightly greater upside risks to oil prices from current levels, EUR/USD could come a little lower over the coming sessions. However, good demand should be found once again at 1.1650. On the calendar today is the second release of 1Q26 eurozone GDP – expected at 0.1% QoQ – and a few ECB speakers. The big speeches from Christine Lagarde and Philip Lane do not come until this evening, however. Expect them to hold out the prospect of an ECB rate hike in June, otherwise the euro will get hit.

*Chris Turner*

## ➔ GBP: Starmer clings on

Sterling finally saw some independent weakness yesterday as Westminster politics moved front and centre. As it stands, Keir Starmer intends to stay on as prime minister and run in any leadership contest against challengers. Those challengers, such as Wes Streeting, Andy Burnham or Angela Rayner, have yet to formally declare themselves in the race. Today could prove a day of rest in political manoeuvring, given the state opening of parliament and King Charles delivering Labour's planned legislation over the next term. However, any of those candidates formally launching a leadership bid would probably result in fresh sterling losses – especially any news on Andy Burnham, whose policies are seen threatening the gilt market.

High yields are probably providing sterling with a little insulation at the moment, but we would expect good demand in EUR/GBP under 0.8650.

*Chris Turner*

## ➔ CEE: Newsflow from Hungary is running out of steam but the story remains bullish

The Czech Republic will publish the final estimate of April inflation today. The headline should be confirmed at 2.5% YoY after a quick jump from multi-year lows to 1.4% in February. The flash estimate suggested that core inflation rose from 2.9% to 3.0%, which will be the market's focus today. At the same time, the structure of service prices will get some attention, where we already saw growth in imputed rents and other items in YoY terms in March, which is worrying the Czech National Bank. At the same time, the market is again pricing in three rate hikes, up from two last week, in the one-year horizon, heading in a hawkish direction once again.

Elsewhere in the region, we continue to monitor the steps of the new Hungarian government, where yesterday the newly appointed Minister of Finance spoke about the plan for euro adoption, meeting the criteria by 2030 and revising this year's budget and setting a consolidation trajectory in the future. All this is exactly what the market wants to hear, and we saw rates and bonds once again outperforming CEE peers.

On the other hand, the minister also mentioned the preference for lower bond yields over further FX gains. The comment comes after a more than 5% rally since the general election in April. The comments, together with the risk-off global environment, are driving EUR/HUF higher, closing above 358 yesterday, back to last Thursday's levels. Of course, positioning is heavy and the news flow from Hungary is drying up. As we discussed here on Monday, some corrections are expected in the current environment, but in our view, there is still some room for optimism, and the market will use the current weakness in the forint as an opportunity for new longs, and we keep 350 EUR/HUF as our mid-year forecast.

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