

FX Daily: The big reveal from the ECB

FX markets are calmer following some stability in the Mexican peso. That said, uncertainty around the next South African government leaves the rand under pressure. Today's focus will be very much on the first ECB cut and any indications about their plans. We doubt the ECB will have much to say about future rate cuts, meaning the euro can edge up



⬇️ USD: Still favour the downside

We have been bearish on the dollar this week and still favour the downside. In reality, it has not moved too much, having first been caught in the crosswinds of the carry trade unwind on Monday and Tuesday and then yesterday finding some support on a better-than-expected ISM Services figure. This figure may, in fact, [overstate business confidence](#). Our team had a good call on the Canadian rate cut yesterday and we were right to think that Canadian yields could drag those of the US down with them. However, we'll probably have to wait for tomorrow's US May jobs report to see whether the dollar can break out of its trading range, which looks to be 104.00 to 104.65 for DXY.

On the subject of the high-yield FX sell-off, attention turns to South Africa today. The ruling ANC – which performed poorly in the recent elections – yesterday un-nerfed markets by suggesting it

would be forming a 'National Unity' government – one that included left-wing parties intent on nationalising large chunks of the South African economy. The ANC's executive committee meets today to decide on how to move ahead. Depending on what mandates are given to the left-wing parties the rand could have another large leg lower.

Chris Turner

📈 EUR: Timid ECB cut should not rock the FX market (up)

The ECB has virtually pre-announced a 25bp rate cut at today's meeting, and while holding could make sense given the latest wages and CPI data, the reputational risk is too high. Should they surprisingly hold, the euro could face a brief earthquake. Here is our market preview of the meeting.

But, as mentioned, a cut looks almost guaranteed and is fully priced in, so the attention will be on communication. We think it is likely there will be almost no new forward guidance, with the ECB potentially signalling any further easing would only be gradual (in line with off-meeting comments) and that there are still risks to inflation. Inflation forecasts will be watched closely, although the ECB should backpedal towards short-term data dependency, so building policy expectations on new projections would be quite speculative, if not misleading.

The risks to the euro appear slightly tilted to the upside today, but we doubt this will be a huge event for FX. Unless President Lagarde revamps some of her eloquence (she has seemingly made press conferences intentionally uneventful), then the FX market may be left with more questions than answers.

The US story isn't only the naturally dominant one in EUR/USD but also the most dynamic at the moment, with still elevated uncertainty around the Fed's first cut. So, we suspect EUR/USD will rather quickly default to looking at US data and payrolls, above all. Our 1.10 call for EUR/USD for 3Q and 4Q currently embeds 75bp of easing by both the ECB (today's cut included) and the Fed in 2024.

Denmark's central bank, whose mandate is to keep stability in the EUR/DKK exchange rate (currently at the central peg level of 7.46) will likely cut rates by the same 25bp a few hours after the ECB.

Francesco Pesole

📉 CAD: BoC cut to be followed by more in 2H

The Bank of Canada [cut rates by 25bp yesterday](#), but weakness in the Canadian dollar was rather limited and short-lived. As discussed in our meeting review, markets were already pricing in 20bp ahead of the meeting, and the BoC reiterated data dependency while stressing lingering risks to inflation. That – and the fact that CAD had weakened against all other commodity currencies into the meeting – explain the relatively contained FX impact.

Our call is for 75bp more cuts by the BoC in 2H24, which is more dovish than the market's 50bp. A further dovish pricing in the CAD curve is likely retrained by expectations that the Fed won't cut more than twice this year, as the assumption is that the BoC doesn't want to widen the gap with the Fed too aggressively. But we think markets are both underestimating the chances of more easing by the Fed and the chances that the BoC will want to keep moving autonomously, as they

have already done. Markets are also seemingly turning a blind eye to Governor Tiff Macklem's reluctance to rule out a July cut. In his words, the BoC will take decisions "one meeting at a time": another fall in inflation may put them on the spot already in July, even if September looks more likely for the next cut, in our view.

We think CAD continues to look like the least attractive commodity currency in G10. NOK, AUD and NZD can all count on hawkish domestic central banks, are more undervalued, and should rally faster in a scenario where USD rates decline this summer. When it comes to USD/CAD, our Fed call means that we see room for USD/CAD to move lower as the USD may well underperform all other currencies this summer, so a drop below 1.35 remains our base case for 2H24.

Francesco Pesole

CEE: Charged for gains

As expected, the National Bank of Poland left rates unchanged yesterday. The statement did not bring much news. The NBP seems to want to present the same picture despite the downward surprise in inflation, which is reflected in the statement with only a slight change in the wording. So the governor's press conference at 2pm local time will get more attention today.

In addition to the NBP, today, we will see several data points within the region. This morning, we have already seen April retail sales data in Romania and Hungary. Later, we will also see industrial production, construction, and trade in the Czech Republic, adding to the picture of economic recovery in the CEE region.

In the FX market yesterday, we saw the first clear signs of a calming down after the recent sell-off across the EM space. The whole of CEE FX bounced yesterday and in our view has charged up for further gains. Although we may see gains everywhere in the coming days, looking ahead, we think we need to differentiate within the region. The CZK has barely moved amid significant volatility elsewhere, confirming the market's long view and positioning, as well as a stronger connection to the rate differential, which points more towards 24.700 EUR/CZK. Although we believe the CZK has already rebounded permanently from its lows, for now we think yesterday's gains went too far. However, we can imagine further gains in the second half of the month thanks to the hawkish CNB. EUR/HUF has closed the gap with rates in our view and although it moved back closer to 390 yesterday we believe this is not the start of a HUF rally to previous levels. On the other hand, PLN may offer attractive levels for new long positions. PLN's strong fundamentals have not changed here and we see it as somewhat undervalued. In addition, today's NBP press conference could help it back to 4.270-280 EUR/PLN, as first stop lower.

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