

## FX Daily: Transatlantic divergence keeping EUR/USD bid

EUR/USD remains close to the highs of the year as a Fed pause and simmering banking crisis cut the dollar's short-term yield advantage over the euro. Today should see a 25bp ECB hike and it is now probably stretched positioning which is the biggest headwind to further EUR/USD gains. Also, look out for a 25bp hike from Norges Bank today



### ↓ USD: That's all folks

When contributing to ING's [Fed review comment last night](#), the dollar was only slightly weaker at the end of Chair Jerome Powell's press conference and the US yield curve had barely budged on the news that the Fed was shifting to a meeting-by-meeting approach to monetary policy setting. However, in the final few hours of US equity trading, US regional banks - especially PacWest - came under renewed pressure on reports that Pacwest was 'exploring options'. Given that First Republic equity and bondholders were wiped out this week, that clearly caused some concerns. The point here is that the 15bp decline in US two-year yields overnight seems to have been driven by the

banking crisis - not the Fed commentary.

Nonetheless, the dollar's yield advantage continues to dwindle, leading to some modest weakness in the DXY - now down around 0.5% on the week. The nature of the decline in US yields has relevance for the FX market as this is not the kind of benign dollar decline that benefits all currencies. Those currencies with the highest correlations to US equities look more exposed (e.g. the commodity currencies of the Canadian and Australian dollars), while the least correlated - such as the Japanese yen and Swiss franc should outperform. This would be our near-term preference given that the US banking crisis is showing no signs of slowing. This also raises the question of what US policymakers can do here with an increasing focus on whether the FDIC can somehow increase deposit insurance coverage - at least for transactional or business accounts. Watch this space.

For today, a lot of the focus will be on the European Central Bank meeting. But in the US, there will again be focus on the initial jobless claims numbers and whether any substantial rise (dollar bearish) signals some easing in US labour supply. The big data comes with the April nonfarm payrolls report released tomorrow.

Overall expect DXY to stay soft - unless we start to see any dislocation in US money markets again such as a sharp widening in the euro cross-currency basis swap or a much higher FRA-OIS money market spread. The DXY year low is around 100.75/80, below which 100 beckons.

*Chris Turner*

## ➔ EUR: Positioning is probably the biggest headwind to EUR/USD

EUR/USD remains close to the highs of the year - but has yet to take out the 1.1100 level. Today should see the ECB [hike rates 25bp](#) (taking the deposit to 3.25%) and the language should remain quite hawkish given [sticky core inflation](#). Markets price, after today, two further 25bp rate hikes into October - at a time when the market is also pricing Fed cuts. This is helping to narrow two-year EUR:USD swap differentials. At 65bp in favour of the dollar these are at the narrowest levels of the year and EUR/USD supportive.

There is a risk that the hawkish ECB sends EUR/USD through 1.1100 today, but a) long positioning is quite stretched and b) a hawkish ECB is priced. This warns that EUR/USD could hang around this 1.10 area a little longer - particularly were the US equity sell-off to gain momentum. Also, watch out for how EUR/USD trades after the 16CET FX options expiry today. There is some talk that an FX options barrier is being protected at 1.1100.

*Chris Turner*

Elsewhere, Norges Bank is due to hike its policy rate by 25bp, in line with its recent commitment to take rates a few notches higher as inflation has remained sticky and - above all - the krone has remained weak. Since the latest policy meeting in March, NOK has continued to depreciate, although largely in line with the bank's projections. So, a surprise larger hike seems unlikely, also considering the vulnerability of the domestic property market. We discuss the relevance of the krone for Norges Bank's policy and the outlook for [NOK in this note published earlier this week](#). In a nutshell, we expect limited NOK impact today, NOK volatility and vulnerability to remain the norm in the near term, but a recovery in the second half of the year, when we target sub-11.00 levels in EUR/NOK.

*Francesco Pesole*

## ➔ GBP: Softer dollar helping GBP/USD

One could be forgiven for thinking that there has been a major re-appraisal of sterling now that GBP/USD is trading closer to 1.26. In fact, this is mostly a dollar move and trade-weighted sterling has not moved much this week. It seems that the view that European banks, including the UK, are better regulated than those in the US is providing some insulation to European currencies. This is also helping to keep expectations alive (expectations with which we disagree) that the Bank of England can hike rates two to three more times this year. Our latest views are that the BoE may not push back against these expectations next week - which would see sterling hang onto recent gains.

Expect EUR/GBP to remain steady (slight upside bias) near 0.8800, while GBP/USD could trade up to 1.2650/2750 - should EUR/USD manage to break through 1.1100 with momentum.

*Chris Turner*

## ⬆️ CEE: Post-Fed sentiment will decide whether region can rally

The Czech National Bank (CNB) [delivered the most hawkish message possible](#) without hiking rates. For the first time since August last year, there was more than one vote for an interest rate hike and the governor said there is a possibility that the CNB will hike rates at its June meeting. With two new inflation numbers in hand by then, which should show a big downward slide, we do not think a rate hike will happen. However, the CNB will remain the most hawkish central bank in the region.

Of course, the global story today will be more important for FX in the region, but we still believe the CZK will catch up with the massive interest rate increase in the market. For now, according to our models, the higher interest rate differential points to a range of 23.30-40 EUR/CZK. However, we can expect rates to rise further in the market today before the dust settles and we will see more headlines from the CNB. On the other hand, if global market sentiment turns negative after the Fed meeting, it may slow or halt the koruna's rally. However, a higher EUR/USD indicates stronger levels for the rest of the region as well.

*Frantisek Taborsky*

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