FX Daily: Unorthodox correlations

With the yen bearing the brunt of the risk rally, the dollar saw some delayed benefits from the re-tuning in Fed rate expectations and enjoyed a modest recovery yesterday. Today, all eyes will be on CPI data from Germany and Spain. Elsewhere, USD/MXN could break below 18.00 today as Banxico hikes and oil stays supported

USD: Dollar takes a breather as yen takes a hit

Yesterday's moves in the FX market provided another confirmation that we cannot apply the traditional frameworks to the interaction between currencies and other assets. If diverging monetary policy paths (at least as perceived by the market) in the US and Europe are gradually reconstructing the link between USD/European FX and front-end rate differentials, the interactions between safe-havens, high-beta currencies and swings in the equity market continue to prove rather unorthodox.

An important point is that the dollar's safe-haven status was perhaps dented by the fact that the banking turmoil has primarily been a US story. Furthermore, another safe-haven currency, the Swiss franc, got caught up with idiosyncratic banking stress, leaving the yen to benefit widely from the initial shock – especially considering its high inverse correlation with Federal Reserve rate expectations. This helps us understand the underperformance of JPY since the start of this week and especially yesterday. Improving sentiment asymmetrically hits the yen given it is accompanied by an unwinding of dovish Fed bets: the USD/JPY level might rebound to the 135.00 area, even though we favour another decline in the pair beyond the short term.

The bloc of pro-cyclical currencies remains extremely homogeneous. Markets have fallen out of love with the Aussie dollar as lower inflation points to a stronger chance of a pause in rate hikes and the New Zealand dollar is now looking like a more attractive option in the region. Oil-sensitive currencies may continue to enjoy decent momentum as we see more upside risks to oil prices. The Canadian dollar is also benefiting from the general improvement in American (North and Latam) sentiment but lacks a domestic tightening story, so its rally may start to run out of steam sooner than other peers (like MXN and NOK). We think the Mexican peso has more room to rise, as discussed in the MXN section below. We see Norway's krone as more attractive than Sweden's krona in the near term.

Back to the dollar, we think the small recovery seen yesterday could be one of many along a gradual decline path, but would favour some consolidation around current levels today. Today's calendar sees the third release of fourth-quarter GDP figures, plus speeches by the Fed's Thomas Barkin, Susan Collins and Neel Kashkari.

Francesco Pesole

EUR: First CPI readings in focus

Preliminary March inflation readings in Spain and Germany will be closely watched today. The German figures will obviously draw greater interest, and consensus expectations are for a deceleration from 8.7% to 7.3% in the headline rate. Spanish numbers will be published earlier this morning and we must remember that they did trigger some market shake-up recently. Expectations are for a flat core rate at 7.6%, but a sharp deceleration in headline inflation from 6.0% to 3.7%.

With the European Central Bank explicitly data-dependent despite an implicit hawkish bias, this week's inflation figures are set to be an important driver of the market's rate expectations. There are currently two 25bp rate hikes fully priced in by September in the OIS curve, and the bar for another hawkish repricing is set quite high. However, ECB speakers have leaned on the hawkish side of late and the EUR OIS curve is not discounting banking stress in the same way the USD OIS curve is.

The EUR/USD rally took a break around 1.0840 and we could see it hover around those levels today, but we still favour a break above 1.0900 and ultimately a test of 1.1000 in the near term.

Francesco Pesole

MXN: 25bp hike by Banxico, and maybe a break below 18.00

We think the Mexican peso's bullish momentum may have further to run. Today, Banxico will announce monetary policy and we expect a 25bp rate hike to 11.25%. This is a consensus view and markets are almost fully pricing in this outcome, so most of the focus will be on forward-looking language.

Recent banking turmoil would suggest policymakers will hold a more cautious stance on the future path of monetary policy. However, market pricing suggests investors have already scaled back expectations for additional Banxico tightening beyond today's hike. If anything, leaving the door open for more tightening if needed as the Bank reiterates its resolution to fight inflation might see some positive impact on the peso.

Beyond the central bank risk event, we think MXN remains attractive in an environment where markets favour currencies with high carry and positive exposure to rebounding crude prices. A break below 18.00 in USD/MXN may be on the cards soon, potentially today on a hawkish surprise by Banxico.

Francesco Pesole

CZK: Koruna welcomes hawkish Czech National Bank

The CNB board decided yesterday to keep the key interest rate at 7.00%, in line with expectations. Also, unsurprisingly, six of the seven members were in favour of the decision, while one voted for a 25bp rate hike. The board also confirmed that it would "continue to prevent excessive fluctuations of the koruna". The governor during the press conference commented on market expectations of a peak in interest rates at current levels and a significant rate cut this year (roughly 125bp in cuts priced in before the meeting). However, according to the governor, a rate hike cannot be ruled out and rate cut expectations are premature at this point.

The Czech koruna visibly welcomed the CNB's hawkish tone and moved below 23.60 EUR/CZK for the first time since the sell-off in global markets two weeks ago. The central bank has confirmed that it is ready to intervene if needed, but current levels are far from where the CNB was last active. On the other hand, the central bank's statement is clearly supportive for the koruna and implies that the currency is safe in the event of a global sell-off. Moreover, with the prospect of higher rates for a longer period of time, a solid FX carry is also certain. Overall, the koruna thus offers decent risk/reward and we expect it to strengthen further.

Frantisek Taborsky

Author

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

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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