FX Daily: Updates on repatriation, China UST holdings and the Fed

FX markets are a little calmer, but traded volatility levels remain elevated. What interests us today is the February Balance of Payments data in the eurozone and the Bank of Canada rate decision. Later today we'll also have a speech from Fed Chair Powell and February data for China's holdings of US Treasuries. In all, expect USD to trade on the soft side

Federal Reserve Chair Jerome Powell speaks tonight

USD: Focus could switch to the Fed

Traded levels of FX volatility have edged down a little, but they're not collapsing. And equally, the dollar has been slow to reclaim any of its recent losses even as equity markets have stabilised. Looking back at last week, we think most asset classes reacted as they should have to the trade shock – apart from Treasuries. Here, as the dust settles, it looks as though we've seen an unwind of highly leveraged long positions as hedge funds wagered on reforms to the Supplementary Leverage Ratio.

If this is the correct interpretation of events – rather than a mass foreign exodus from the US Treasury market – then US yields can settle a little lower and the dollar does not need to rally much. On the subject of foreign selling of US Treasuries, tonight sees data released on Chinese holdings for February. We doubt it would show much of a change in China's $760bn of holdings, but if we're wrong, a drop could trigger another bout of both US Treasury and dollar selling.

When it comes to US macro, today should see some decent March US retail sales as consumers front-loaded purchases ahead of incoming tariffs. We doubt the market will want to chase the dollar too much higher on any good news here. Instead, the market will be far more interested in what the Fed makes of the current economic conditions. Chair Powell speaks on the subject at 1930CET tonight. If you haven't seen it already, the Fed's Christopher Waller's speech on Monday is a must-read. It's clearly dovish. He presents two scenarios: the current effective 25%+ tariff is here to stay (see our own James Smith's calculations here) or tariffs negotiated back to 10%. Notably, neither scenario delivers a permanent inflation shock, and on the former scenario, his thoughts are that the Fed should cut rates earlier and more aggressively to avoid the unemployment rate heading up to 5%. With long-term inflation expectations derived through the USD 5Y5Y inflation swap currently falling to new lows, a similarly dovish speech from Powell tonight could weigh on the dollar.

We suspect any bounce in DXY to stall in the 100.25/50 area before we see a break of 99.00.

Chris Turner

Elsewhere, the Bank of Canada announces policy at 15:45 CET. After 225bp of easing and, crucially, the USMCA goods exemption from US tariffs, we think a hold is slightly more likely than a cut today (here is our full preview). But this is a very close call, especially considering that yesterday's CPI data for March surprised on the downside, which pushed pricing slightly more on the dovish side (11bp priced in this morning).

Like in many USD crosses, short-term rate differentials are playing second fiddle to idiosyncratic USD risks and tariffs in USD/CAD. Accordingly, the pair is quite cheap below 1.40. The loonie is not as well-positioned as European currencies to benefit from rotations away from the USD, but we expect any USD recoveries to be gradual, if anything, and USD/CAD can still attract sellers around the 1.40 level in the near term.

Franceso Pesole

EUR: Insights into the rotation story

Eurozone Balance of Payments data is typically not a market mover, but today's release of the February data could add weight to the story of a rotation out of US equities and into the eurozone – as some buy-side survey data suggested at the time. The data won't break down what has left US equities, but it should tell us what has come into eurozone equity markets. For reference, in the 12 months to January, eurozone residents put EUR134bn into non-EZ equity markets. This number should in theory fall if eurozone residents are repatriating.

Equally, foreigners bought EUR334bn of eurozone equities over the same period. This number should increase if foreigners (especially US asset managers) are increasing their exposure to Europe, helped by the fiscal stimulus news that month. If the above turns out to be true, investors should have a little more faith in the EUR/USD rally.

EUR/USD may have already put in a short term low and be heading back through the 1.1425 area to test 1.1500.

Chris Turner

GBP: Welcome news on services inflation

Sterling is a little weaker this morning as UK services inflation dipped back to 4.7% in March. At the headline level, CPI has dropped to 2.6% YoY, but our UK economist, James Smith, believes it could push back to 4% by the end of the third quarter on energy prices. Far more interesting, he thinks, will be services inflation in April and May. He believes this could drop still further even though the Bank of England forecasts a bounce back above 5%. If he's right, markets will cement their views of three Bank of England rate cuts this year – the next one in May.

EUR/GBP is unwinding some of last week's spike, but a big EUR/USD bull trend suggests EUR/GBP can find some support near 0.85 and a reversal back to 0.86 is likely over the coming months. GBP/USD is dominated by the soft dollar story and has last yera's highs of 1.3430 in its sights.

Chris Turner

CEE: Second-tier inflation numbers in the region

Yesterday's final inflation numbers in Poland confirmed the previous flash at 4.9% YoY in March, marking this year's peak in inflation. Our economists estimate core inflation at 3.6%, the same as in February. The official numbers will be released later today and the market is expecting a slightly lower 3.5% number with an unusually wide range of estimates from 3.3-3.6% YoY. In the Czech Republic, the PPI for March will be released this morning and we will be looking particularly at agricultural prices, which are in the Czech National Bank's sights due to the pressure on food prices in the CPI.

Yesterday's hearing by future National Bank of Hungary Deputy Governor Zoltan Kurali helped HUF to make some gains and stave off further depreciation above 410 EUR/HUF. Still, we believe HUF is the most globally driven currency within the CEE region and further recovery in European equity markets pushed EUR/HUF lower as well. At the same time, this could help today again, unless we see a change in sentiment, and EUR/HUF could test 407.

PLN and CZK rates market saw some return of payers yesterday, which helped widen the rate differential a bit. While in the CZK market, we believe this is the way to go for the days ahead given the hawkish CNB, in the PLN market, on the other hand, the start of the National Bank of Poland cutting cycle will keep rates tight against the core market. Therefore, we continue to see PLN/CZK moving lower with 5.850 broken yesterday and 5.800 on the table for the next two weeks, in our view.

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