# FX Daily: When hawks fly

This week has seen quite a hawkish set of meetings amongst the EM central banking community. Brazil hiked rates 75bp and promised the same again in June. Policymakers in the Czech Republic are firming up plans for a summer lift-off in rates. And Turkey's central bank kept rates firmly at 19%. This is in stark contrast to the Fed. The $ looks vulnerable again.

## USD: Real rates undermine the dollar

We have seen quite a hawkish set of central bank meetings in the EM space this week and to the list above we would add Russia, where the CBR is engaging in a front-loaded tightening cycle. In the G10 space, those central banks openly discussing normalizing monetary policy have seen their currencies out-perform. We highlight this in the latest edition of our global monthly, where CAD and NOK lead the pack in this regard. And even though the US is at the top of the list of those countries closing output gaps and in theory needing to withdraw loose policy, the Fed's new monetary policy strategy has muddied the waters in this relationship. Indeed, despite a generally positive set of US releases this month, US 10 year real yields have dropped around 10bp this month - largely on the view that the Fed remains on the sidelines. The big focus today, of course, is the US April NFP. A 1 million increase is expected in the headline figure. Upside surprises to this do in theory mean that the Fed is making quicker progress towards its goals of maximum employment and brings tapering nearer. But until the Fed is ready to change its tune from 'now is not the time to talk tapering', - enough to drive nominal US rates substantially higher - we think the dollar stays offered. Supporting that position is the global recovery story. China released strong trade and PMI data overnight and it is good to see USD/CNY on the move lower again. We are also seeing some of the more speculative commodities, such as Silver, starting to gain momentum - suggesting the pendulum is swinging towards a softer dollar. We favour DXY making a run to 90.50 today.

## EUR: Time for some catch-up

While the EUR certainly finds little support from the monetary normalization narrative, it does derive benefit from being a pro-cyclical currency. Better China data and now stronger Eurozone data, not only from the business side but now from the consumer side too suggests EUR/USD has a window to advance. Look out for a speech from ECB President Lagarde at 12CET today on the State of the Union. We doubt she will want to go near the subject of ECB tapering at the June meeting and will no doubt pressure politicians to accelerate the roll-out of fiscal stimulus. Let's see if EUR/USD can push through 1.2080/2100 today to retest last week's high at 1.2150. We also remain surprised by the decline in EUR/CHF, where next week's Polish supreme court ruling on CHF mortgages may be playing a role. We still very much like EUR/CHF higher, however, and expect time spent under 1.10 to be limited.

## GBP: Waiting on the political event risk

Early indications suggest the ruling Conservatives might have done quite well in the Hartlepool by-election and also in local council elections. There are no indications as yet on Scottish parliamentary elections, where a SNP majority would raise the topic of another independence referendum. This is an event risk that could hold GBP back, but otherwise an optimistic assessment from the BoE yesterday should continue to see GBP supported. Here UK equities are the most unloved in buy-side positioning surveys and a re-rating of the prospects for the FTSE should be a GBP positive. Let's see if Cable can test and break 1.40 post NFP today.

## ZAR: The currency you hate to love

Despite weak growth and terrible levels of debt, the ZAR remains the top performer in the EM FX space this year. Driving that strength is undoubtedly the commodity boom, where price increases in key exports of precious metals and minerals served up South Africa with a record ZAR52bn trade surplus in March.  It is hard to see this trade story turning any time soon. Pressure on EM currencies in the first quarter also curtailed the SARB's easing cycle. SARB projections discuss rate hikes in 2Q and 4Q this year. The market prefers a back-loaded 75bp hike. Yet the longer the ZAR can hold these strong levels, the more likely SARB delays its tightening cycle - especially since indicators such as private sector credit growth are contracting 2% YoY. Delaying the tightening cycle could be good news for the local SAGB bond market, where 10-year yields offer 9%. It could also be good news for the ZAR on the back of inflows to the SAGB market. Of course, the ZAR requires a health warning given its very high beta on the global growth/risk environment. But as long as events do not conspire to deliver early Fed tightening - or a global growth shock - $/ZAR has a window to break to new lows under 14.15.

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