Brexit heat set to ease this week

With an extension to Article 50 agreed and Parliament on Easter recess, we get a break from Brexit news this week. Here's what that means for sterling

USD: Solid US data to undermine case for Fed rate cut

The US data scheduled for this week should show that the market pricing of a Fed funds rate cut for this year remains rather premature. The March retail sales (Thursday) and February trade data (Wednesday) should paint a picture of a solid US economy. As our economists point out, the Atlanta Fed's GDPNow model is pointing to 1Q GDP growth of 2.3%, based on the data received so far, and the upcoming reports have the potential to push that growth rate well above 2.5%. This suggests little sign of a recession yet. Such readings should be supportive for risk sentiment (i.e. solid economy but still cautious Fed which is no longer on autopilot) and further help emerging market FX. The Mexican peso remains our top EM pick. USD/MXN already broke the 18.80 support level and the peso is set to benefit further. Despite yet another attack from President Trump on the Fed's independence over the weekend, we don't expect the central bank to change course and cut interest rates.

EUR: Looking for potential signs of green shoots

It is a fairly quite start to the week on the eurozone data front, with the key event being the April PMIs on Thursday. Following the upward revision to the initial March releases, all eyes will be on any additional signs of stabilisation – mainly the Manufacturing PMIs which have remained in contractionary territory. Signs of stabilisation should modestly help the euro and prevent EUR/USD from slipping below the 1.1200 level this week.

GBP: Brexit heat set to ease this week

Brexit heat is set to ease this week as an Article 50 extension was agreed and Parliament is on Easter recess. Cross-party talks between the Prime Minister and Labour will continue in the background, but the odds of a positive outcome are rather low. Although some UK data this week should be positive (wage growth looks set to remain strong), the positive spillover into sterling should be fairly limited as the prospects of a Bank of England rate hike this year have been dented. EUR/GBP to stay above 0.8600 today with a bias towards 0.8800 in coming months as a possible Conservative party leadership contest unravels (see Brexit: We expect sterling gains to stall).

JPY: Moving above the 112.00 level

USD/JPY is testing the 112.00 level and we expect the cross to break above this level this week in response to solid US data and stabilising risk appetite. The prime driver of USD/JPY remains US data and the risk environment, with domestic Japanese data having a limited impact on the currency at this point.