High bar of USD strength despite higher CPI

Will the Fed acknowledge any tightening of financial conditions? Here's our Wednesday FX outlook

The US dollar moving sideways

Investors will be scrutinising the FOMC Minutes today for thoughts on trade, inflation and the recent widening Libor spreads (see Three things the Fed is thinking about). We are particularity interested in the latter, and whether the Libor-induced tightening of financial conditions (which could be perceived as the equivalent of at least an additional 25bp Fed funds hike) could mean that the Fed has to hike less.

The Fed acknowledging this tightening would be USD negative as it could lead to some dovish re-pricing. As for today's March US inflation, the core prices look set to return to the 2% target (or even slightly above) as a distortion related to cell phone data pricing drops out of the annual comparison. However, with a fair degree of policy tightening priced in this year, the CPI data should not provide an impetus for a material USD rally.

EUR: More signs of the eventual second step of ECB policy normalisation

EUR/USD is pushing higher, being prompted by the ECB Nowotny comments on the deposit hikes. Although the ECB immediately published a somewhat rare comment stating that "Governor Nowotny's comments are his own", the notion of the upcoming second step of ECB policy normalisation (the depo hikes) and its positive effect on EUR is the key factor behind our bullish EUR/USD view.

RUB: Opening Pandora's box

RUB has come under a heavy pressure since the start of week in response to the US sanctions. In Russia sanctions: Opening Pandora's box? Dmitry Polevoy notes that some of the RUB weakness has been exaggerated by the consensus long positions in RUB and local assets. Unless there is significant widening of the sanctions list (not our base case at this point) we still see RUB stabilising at better levels over the course of 2018 due in part to the stable oil price.

PLN: Dovish NBP to have only a short-lived negative impact on PLN

In today's rate setting meeting, our economists expect the Polish central bank to reaffirm its dovish rhetoric, especially after a very soft CPI inflation reading in March (flash estimate at 1.3% YoY, with core CPI close to 0.5% YoY). During the press conference, Governor Glapiński is likely to confirm that interest rates hikes are unnecessary in the low inflation environment. We expect any negative impact on PLN to be short-lived unless the Council clearly points to rate cuts (unlikely in our view at this point) given that:

(a) Plenty of dovish re-pricing is behind us (market now pencils in only 33bp worth of hikes in total by end 2019);

(b) PLN benefits from bond inflows – a result of both dovish NBP and improving credit rating outlook;

(c) Expected solid activity data. We target EUR/PLN 4.10 in six months.