US dollar rally: Enough already

Some of the high-yield emerging market currencies most under pressure recorded sizable gains on Thursday. Will the gains hold?

USD: Enough is enough

There are some tentative signs that the storm of dollar buying might have blown itself out. Some of the high-yield emerging market currencies most under pressure recorded sizable gains on Thursday after the core US CPI figure rose a benign 0.1% month-on-month in April. The biggest potential dollar positive risk of the week has therefore been negotiated. The US data calendar does not look especially threatening to dollar bears next week and instead we'll be looking to see whether EM high yield can hold onto its gains. Here the focus will be on whether: i) Argentina gets its IMF deal ii) Brazil's rate cut is signalled as its last, iii) Mexico gets some positive news on Nafta (deadline May 17/18) and iv) the threat of a defensive 100bp rate hike to support the Turkish lira remains credible. Clearly EM investors are hoping (and praying) that the dollar rally is nearly over, but as long as EM growth rates hold up and dollar rates don't have another discrete 25bp move higher, we think positive investment trends will dominate. Being dollar bears, we think there is a chance that the dollar index (DXY) puts in an important high at 93.42 on Wednesday and we would now favour a tentative decline to 92.00.

EUR: Draghi speaks at 1515CET

We see tentative signs of a significant EUR/USD low in place at 1.1825 on Wednesday - or perhaps it at least defines the lower end of a new 1.18-1.21 trading range. A close today near 1.1950 – where EUR/USD opened the week – would help this story. Look out for a speech from ECB's Mario Draghi at 1515CET at a State of the Union event. Investors are looking for confidence that the Eurozone slowdown in 1Q18 was driven by temporary factors such as strikes, weather and flu and that the ECB's exit strategy is on course.

GBP: Down but not out

We think that the market has over-reacted a little to yesterday's Bank of England event and an August rate hike is still a possibility. Cable should find good demand under 1.35.

CAD: April employment to shed light on next BoC rate hike

Canada releases April employment and wage data today, which may shed some light on whether the Bank of Canada will wait until the 11 July meeting to hike – or perhaps will consider a move at the 30 May meeting. BoC Governor Stephen Poloz sounds relaxed on the prospect of rate hikes, having recently told parliament that capacity constraints are not as tight as once feared. Still a good employment figure, especially where wages push higher, could see the market consider the 30 May meeting a little more seriously – currently the market prices in about a 40% probability of a hike. With crude prices stronger and likely to help a key engine of Canadian growth this year - business investment – we prefer to look to the CAD positives. USD/CAD could see 1.2710 on a good jobs number.

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