USD: Powell put stabilises markets

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How far will Fed Chair, Jerome Powell, push back market expectations?

USD: Powell's put stabilises the markets

Remarks by Federal Reserve Chairman Jerome Powell that the bank is flexible in terms of interest rate setting and may ease policy should economic conditions warrant it lifted risk assets, offering some insurance to a possible deterioration in the trade conflict. That said, this (a) still does not mean the Fed is fully pre-committed to cuts this year – rather this will be data dependent; and (b) if it does cut, it is hard to see the bank delivering more than the two and a half cuts that are already priced in by the market for 2019. This is because the Fed would most likely move during meetings with new economic projections (i.e. once a quarter) and it doesn't seem likely that the Fed would act as early as June. Stock markets are nevertheless rebounding, which should benefit higher beta G10 FX vs the US dollar. Given the extent of the dovish re-pricing of the Fed outlook and the collapse in US Treasury yields in recent weeks, the dollar losses appear fairly muted. On the data front, all eyes are on the US May ISM non-manufacturing, given the Fed's data dependency. A stable reading today should ease concerns about an imminent deterioration in growth prospects, and so reduce immediate expectations for any Fed easing and stabilise the dollar, mainly against the low yielders such as the euro and yen (with the latter losing some support due to rebounding stock markets).

EUR: Data doesn't point to euro strength

While April eurozone retail sales should show solid year-on-year growth of 1.5%, yesterday's lower than expected CPI is likely to put further pressure on the European Central Bank tomorrow and keep the dovish bias in place. This, in turn, should prevent meaningful upside for the euro.

GBP: Another downside risk to UK data

The UK May Services PMI should remain fairly subdued as the Brexit noise continues to weigh on business sentiment. We see the non-negligible likelihood of a downside surprise (below 50) following the disappointing manufacturing PMI earlier in the week. This should keep any GBP upside potential in check and, after briefly hitting the 0.8900 level yesterday, EUR/GBP should stay in the 0.8800-0.8900 range.

PLN: MPC firmly on hold

In Poland, the monetary policy committee is widely expected to keep interest rates unchanged, with the committee's discussion likely to be focused on the 2020 CPI outlook. We do not expect a material change in the communication as our CPI forecast for 2020 (2.8% YoY) remains close to the central bank's March projections (2.7%). As for the zloty, it lagged its peers during yesterday's CEE FX rebound. This is likely due to the (new) perception of PLN being a safe haven in the region (given that the Czech koruna is overbought and there are clear fundamental issues with the Hungarian forint) which led to PLN outperforming during risk-off days last month.

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