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Weekly Report

Weekly FX Market Update

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, Roman Ziruk & Itsaso Apezteguia

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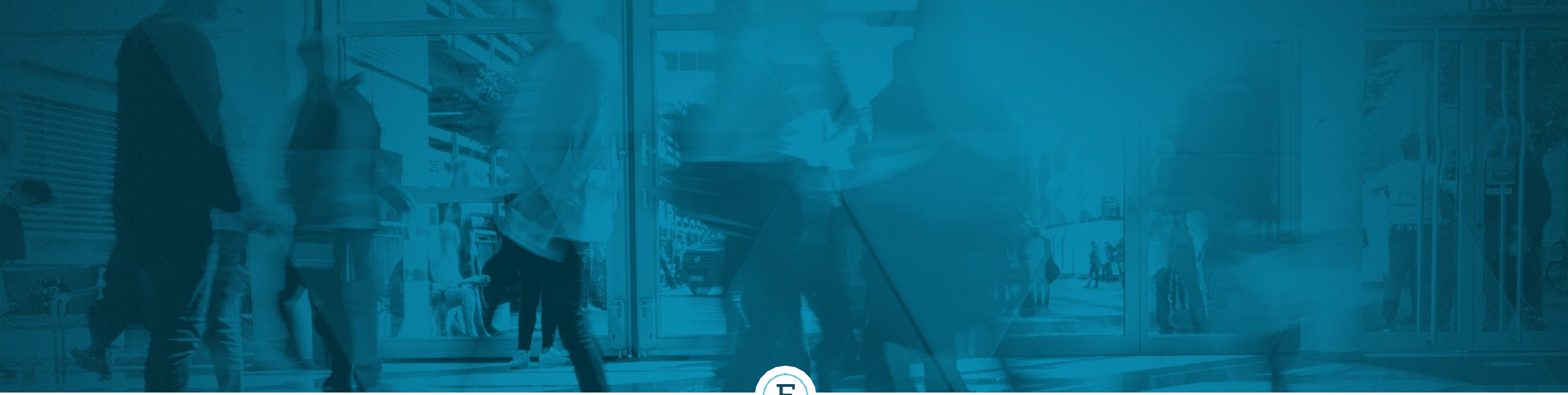


US dollar sell off continues as risk appetite returns

Stock markets and risk assets in general rebounded strongly last week, while US rates did not.

The result was a predictable dollar sell-off, with the main beneficiaries the European and Latin American currencies. The former was boosted by the closing rate differentials across the Atlantic, the latter by the return of risk appetite in general and the blistering commodity rally in particular. Special mention to the Polish zloty, which topped the week with a stellar performance in realisation that the Polish economy has been resilient to the war's impact so far, while the country edged closer to unlocking funds from the EU's pandemic recovery package.

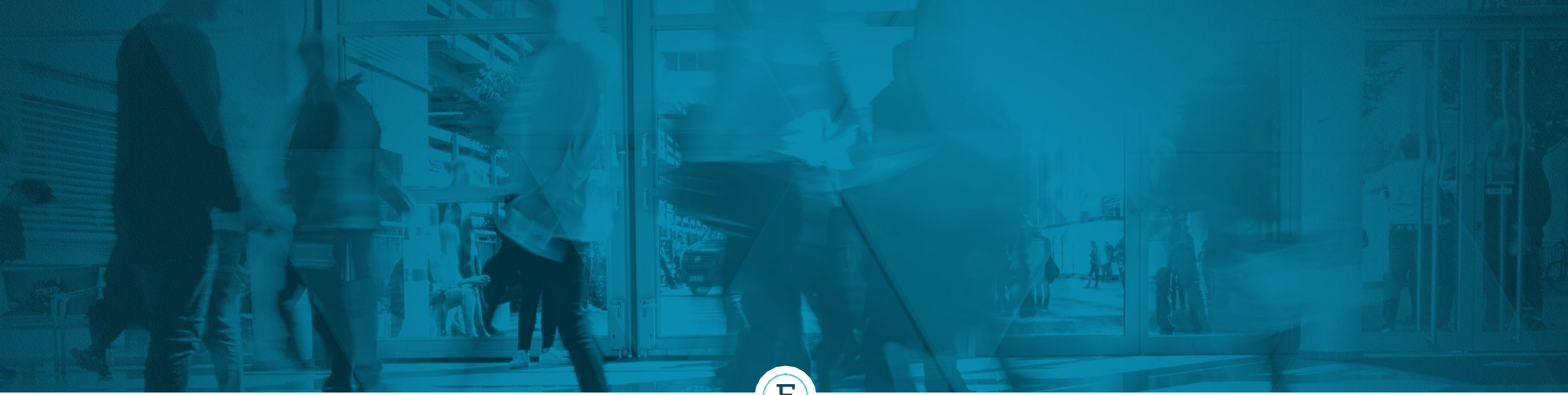
Macroeconomic data out of the main currency areas will be front and centre this week. The Eurozone flash inflation report for May is out on Tuesday, and the key payrolls report out of the US will cap the week on Friday. As for the former, markets expect yet another increase in both the headline and core index, which should seal the deal for an ECB rate hike no later than July. As more and faster ECB hikes are incorporated into expectations, the euro should receive a significant boost, and its recent rebound may have further to run.

CZK

The Czech koruna sold off slightly last week despite largely favourable external conditions in what could be a sign that the limit to koruna's strength may not be too far from current levels.

CNB meeting is still a few weeks away, but signals from the MPC suggest we'll see a similar-scale hike to the previous one. On Sunday one of the hawks within the MPC, Tomas Holub said he'll likely support a hike in June and called a 75 basis point hike implied by the market pricing a 'realistic prediction'.

This week will bring first-quarter GDP growth data revision (Tuesday) and manufacturing PMI print (Wednesday). Aside from that, any noises from the CNB will be worth keeping an eye on.



EUR

Last week's Euro Area PMIs for May held up much better than either the UK or the US, in a sign that the economy there is more resilient than it's given credit for. The clearly expansionary numbers dispelled the notion that a recession is near, and what we are left with is monetary policy settings completely out of line with the inflationary and economic backdrop.

Inflation data this week will likely show yet another all-time record level. The number will be key to decide the actual size of the incoming July rate hike, which ECB President Lagarde all but confirmed during her communications last week. A nasty upside surprise in inflation would probably increase the odds of a 50 basis point hike and be supportive of the common currency.

USD

A slew of second-tier data came out mostly below expectations last week. Weakness in the housing market, in particular, helped the US bond market continue its rally and the 12-month spread between US and Euro rates is now lower than it was at the end of March, which no doubt explains much of the euro's recent rebound. With inflation still far above the Fed target, we do not expect this incipient weakness to do much to stay the Fed's hand.

This week, we get the last key data point before the June Federal Reserve meeting - the labour market report for May. Markets are expecting a pull back in wages, which are still lagging prices. A positive surprise here may trigger markets to start pricing in three back to back 50 basis point hikes from the Fed.

Ebury
Stodolní 9 702 00 Ostrava, Czech Republic
+420 558 080 074 | info@ebury.cz | ebury.cz