

FX Daily: Banxico goes early with a hike

Emerging markets are leading the charge with tightening cycles. Mexico and Hungary have this week joined Brazil and Russia with early tightening. Even Korea said yesterday it will start its monetary normalization later this year. Expect these selected EM pairs to stay in demand this summer, although investors will have to be nimble around the Fed.



📉 USD: Benign conditions allow select currencies to advance

DXY continues to very gradually hand back some of last week's 2%+ rally, but the move masks strong moves on the crosses. Most emerging market currencies are up anywhere between 1.5% and 4.5% against the JPY over the last week. And ex under-performing regional Asia, most EM currencies are up 0.5% to 3% against the EUR.

Effectively a flat dollar environment is allowing these selected cross positions to perform. This environment will probably continue today with global equity markets (including Asia for a change) pushing to new highs. US markets received a boost yesterday with news that there has been some progress on the US infra-structure bill (\$559bn bi-partisan agreement from a Senate panel) and also healthy US banks stress tests. It's quite impressive really that the 23 banks stress-tested by the Fed showed CET1 capital ratios still double the minimum capital requirement when stressed by

a scenario of a 4% GDP contraction and a 55% fall in equity prices.

This benign environment lasts until the next Fed shock comes along. Will that be today? Well, the consensus is already expecting quite a large increase in the May PCE inflation data - looking for 3.9% YoY headline and 3.4% YoY core. The bar may therefore be high for a nasty surprise and one that might push the Fed into early tapering and tightening.

Barring a surprise on the PCE inflation, we would say DXY continues to consolidate - perhaps drifting back towards the 91.50 area.

➔ EUR: ECB happy to keep the EUR an underperformer

The ECB has done a good job of making sure the EUR will suffer the lion's share of any dollar appreciation. Unlike an increasing number of EM countries who feel the need to respond to the summer inflation spike, it seems the ECB is more than happy to position itself as not being rushed into premature tightening. That is why the EUR, the JPY and the CHF are the preferred funding currencies this summer. This could change should the ECB have to acknowledge the recovery even more in September, but for now the EUR should under-perform on the crosses.

The current environment should see EUR/USD continue to consolidate, although surprisingly strong Eurozone confidence indicators this week suggests EUR/USD could edge to the 1.1980/90 area over coming days.

Elsewhere, the RUB continues to perform well - backed by the hawkish CBR and high oil prices. We could see a little reduction of core RUB longs over coming days, however. Low vaccination rates in Russia have left it exposed to a new wave of Covid-19 cases. And the [OPEC+ meeting of July 1st](#) poses an event risk to the oil market should the alliance agree to increase supply in excess of 500k bpd.

➔ GBP: BoE disappoints the bulls

GBP was an under-performer yesterday - hit by a BoE that was not quite as hawkish as traders had expected. The BoE was [not particularly dovish](#), but it looked as though the market had got ahead of itself in pricing BoE hikes from summer 2022. The large 5 tick rally in December Short-Sterling contracts certainly suggested that was the case.

Expect EUR/GBP to continue to trade a low volatility 0.8535-0.8600 range, while a default Cable range looks something like 1.3890-1.4010.

⬆️ MXN: Front-loaded tightening to keep MXN in demand

In a big surprise to markets Banxico last night hiked the policy rate 25bp to 4.25%. It was a three to two majority vote. This has been an amazing turnaround in Banxico, which in February would have liked to continue its easing cycle below 4.00%, but effectively had that door closed.

Banxico's statement showed concern that what had been considered transitory inflation could persist longer than expected and damage inflation expectations. Recall that inflation is running near 6.00% YoY and Banxico now estimates that it will not return to target until 3Q22.

Banxico joins the likes of Russia and Brazil (and this week Hungary too) in what could be a front-loaded tightening cycle - as EM central banks try to ride out the summer inflation cycle. The move

shocked the local MXN rates markets, with some short-term TIE rates moving up as much as 35bp on the day as traders move to price another hike at the August 12th Banxico meeting.

The move is a clear MXN positive, showing that Banxico is prepared to take no risks with the inflation cycle. MXN is also enjoying the benefits of \$4bn in remittance inflows per month and could also stand to benefit from progress on the US infrastructure bill. The move could also see a return of foreign interest to the local MBONO market now that 10 year yields have pushed back above the 7% area and that Banxico looks to be taking no risks with inflation. Of course MXN is a high beta currency and will be hit should US yields spike higher - but during bouts of carry interest, such as we are currently seeing, MXN should out-perform the forwards and \$/MXN should trade comfortably in a 19.50-20.00 range.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.