Dollar flexes its muscles

The Fed's policy statement has reinforced expectations for two more rate hikes this year. Up next, the Bank of England

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USD: Strong economy, hawkish Fed, emboldened White House

We were taken by comments earlier this week from US Commerce Secretary Wilbur Ross that current strength in the US economy made it a good time to get aggressive on trade. That certainly looks to be the case, with the market now fearful that Washington ups the tariff levy to 25% from 10% on the next $200 billion worth of targeted Chinese imports. Expect to hear more about this over the next two to three weeks given public hearings take place on these tariffs 20-23 August. That the US economy is in a good place right now was confirmed in last night's FOMC statement where descriptions of "strong" and "strongly" were used liberally and are firming up market views that the Fed will hike twice more this year. Expect the dollar to stay strong into Friday's payrolls and the uncertainty over trade to keep emerging market currencies on the back foot, especially those that are struggling to make the right policy choices, such as Turkey. Asian equities are under pressure today and over coming weeks, with China now using the Renminbi as a trade weapon, we expect those currencies correlated with the yuan to underperform. Outside of the Asian satellite currencies, that probably means downside risk for the commodity complex of Australian dollar, New Zealand dollar and South African rand. The US dollar index looks biased towards the 95.00/95.50 area.

EUR: ECB provides no defence

While others feel the need to tighten policy, the ECB's position of no change in policy until late summer 2019 leaves the euro rather vulnerable. EUR/USD risks 1.1575

GBP: Dovish hike unlikely to spur much upside

The pound under the political cosh is unlikely to find much love from a dovish 25 basis point Bank of England rate hike today. We think the potential for at least one, if not two dissenters (Jon Cunliffe and Dave Ramsden) – as well as cautious rhetoric by Governor Mark Carney in the press conference – is unlikely to engender much hawkish spirit in either UK rates or the pound, not least as both markets remain dominated by the risk of a no-deal Brexit. Here's Viraj Patel's take on the potential scenarios.

CZK: CNB to provide cushion to Koruna

Although today's 25 basis point hike is largely priced in, the Czech National Bank delivering on market expectations should be positive for the koruna. Coupled with EUR/CZK being close to the important 200-day moving average support level of EUR/CZK 25.5650, the interest rate hike should be enough for the cross to break this level and to test 25.5000. The likely new (and hawkish) CNB interest rate forecast (we expect the CNB to signal at least 150 basis points of hikes by end-2019) should provide a cushion to CZK even if Governor Jiří Rusnok delivers a modestly dovish tilt (in terms of a lower pre-commitment to the new staff forecasts).

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com