

The focus on local FX champions

The currency market is no longer primarily focused on Federal Reserve rate expectations. While we expect the Fed to finally cut rates in September as we begin to see softer data, domestic political and central bank stories should determine which currencies will benefit from a weaker dollar



The half-time review

For most of the past year or so, investors and analysts were mostly focused on guessing the timing and size of the Federal Reserve's cutting cycle, identifying that as the main driver for a broad-based dollar decline. Since the end of May, political factors have taken a central role, making the link between a more dovish Fed pricing and a weaker dollar less stable.

We think that FX investors are having to take a lot more into account. And it's not just about politics in the US and the eurozone. It's also about the underlying central bank and economic fundamental stories that can make or break FX rallies in the many risk-on/dollar-off windows we expect to see this summer.

1 Second-half prediction: The strugglers

We believe the euro, sterling, the Canadian dollar and the Swiss franc will struggle more than

others in the G10 to outperform in the next couple of months. We estimate that those are the only four currencies which cannot count on an economic fundamental-based undervaluation against the US dollar. More specifically, the euro may well remain trapped around 1.08 by the French political gridlock and related fiscal concerns despite a relatively market-friendly outcome of the parliamentary election. Sterling may take a hit from the start of the Bank of England's cutting cycle in August, while the Canadian dollar and the Swiss franc could be dampened by ongoing domestic easing and soft data.

Second-half prediction: Unlocking potential

In the undervalued camp, we think central bank policy will be key to unlocking upside potential. The Australian dollar and the Norwegian krone look to be in a good position to lead the pack, as the Reserve Bank of Australia might hike, and Norges Bank should stay hawkish. The New Zealand dollar also continues to look attractive to some, despite the country's central bank's latest dovish tilt, while the Swedish krona has more limited room for appreciation given the Riksbank's easing plans. The yen remains in a vulnerable position as investors continue to test new intervention levels (we believe these are close to 165.0). However, we narrowly favour a Bank of Japan hike later this month, which can join forces with a dovish Fed repricing to start driving USD/JPY lower.

Author

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 <http://www.ing.com>.