FX Daily: 50bp from the Riksbank unlikely to be a game changer for SEK

A hawkish set of commentary in Sintra yesterday has left the dollar bid. Today the focus is on some US inflation data for May and a likely 50bp rate hike from the Riksbank. While the Riksbank may want the Swedish currency stronger for a change, the external environment is unlikely to see investors rushing to the krona

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USD: Market prices a peak in dollar rates around year-end

The dollar remains close to the highs of the year as recessionary fears fail to dent the central assumption that inflation is a problem and that the Federal Reserve is laser-focused on taking rates higher to address it. That seemed to be the central message coming from the European Central Bank's Sintra panel in Portugal, where central bank governors effectively concluded that the low inflation regime was a thing of the past. The current narrative, therefore, means that the Fed is prepared to power ahead with tightening - even in the face of slower activity data and equity weakness - until it is confident that inflation is under control. On that subject, today sees the May US PCE inflation data. The May US CPI data (released 10 June) really hit bond and US rate markets meaning that today's PCE may not have that large of an effect. Yet any upside surprise could nudge the dollar and US rates a little firmer.

Also of note is that money markets now price US short-end rates peaking around year-end at 3.50% and being 25bp lower by next summer. How should the dollar cope with this up-down Fed cycle? For us, it seems far too early to be playing the dollar bear market story. Let's see whether sticky inflation this summer needs to price Fed funds back at 4% again. But into 2023 our baseline view is that the dollar does indeed start to turn lower.

DXY is steady near 105.00. The high of the year is at 106.00. Barring quarter and half-year end portfolio balancing flows today, we would expect the dollar to stay strong.

And the nature of the USD/JPY advance - now becoming a slow grind higher - removes some of the urgency for FX intervention by the Bank of Japan. One month USD/JPY implied volatility remains understandably elevated, but it seems like intervention may not be seen until closer to 140 if moves continue as they are.

EUR: Soggy

The ECB's euro trade-weighted index is languishing at barely 1% off the lows of the year. Clearly the ECB will face much greater challenges in lifting policy rates than the Fed and that seems to be the doubt in the market. Tension from the war in Ukraine and now NATO's expansion makes for a very difficult investment environment and very low interest rates still make it cheap to hedge euro-denominated working capital or balance sheet exposure. EUR/USD seems to have sunk into a new 1.0400-1.0600 trading range and it feels that if the ECB were to start briefing on the chances of a 50bp hike in July, the euro would not get much of a lift anyway.

Elsewhere, EUR/CHF is trading comfortably below 1.00. CHF sight deposit data hints that the Swiss National Bank might have sold CHF5-6bn from its FX reserves in order to get EUR/CHF lower - nominal CHF appreciation now being a central part of the Bank's monetary policy strategy. Given the size of SNB FX reserves, we believe the SNB can be on both sides of EUR/CHF to guide it gently lower - perhaps seeing realised and then implied volatility fall too. Today will also see the SNB release FX intervention data for 1Q22. This could see some small SNB FX buying, following CHF12.6bn of purchases in 4Q21. Yet that policy has now reversed this month.

GBP: On thin ice

The UK has just released a £51bn current account deficit for 1Q22. That may be a function of reopening/lockdown sequencing between the UK and trading partners - but it is not a good look. The Bank of England (BoE) is going to have to stay pretty hawkish - or at least not protest against current market pricing of the BoE curve - if it wants to keep sterling supported.

GBP/USD to stay vulnerable. Under 1.2100/2115 could see the 1.1950 low retested. And sterling is doing very well to retain EUR/GBP levels near 0.8600.

SEK: 50bp hike by the Riksbank today

The Riksbank announces monetary policy today and we expect a 50bp rate hike (see our full preview here), in line with the economists' consensus and market expectations. CPIF inflation in

Sweden has exceeded the most extreme of the scenarios outlined by the Riksbank in April, and that would by itself warrant an acceleration in the pace of tightening. Incidentally, the Riksbank has fewer policy meetings than any other developed country's central bank, which means that the Bank has less flexibility than others to a more gradual tightening approach.

As markets are fully pricing in a 50bp hike today, most focus will be on the rate projections, where we expect the Bank to pencil in a 50bp hike also in September and potentially another 50bp in November, with the latter possibly coming as a partly hawkish surprise to markets.

Indeed, the currency debate is quite central in Sweden, and the Riksbank would most likely welcome a re-appreciation of the krona to fight imported inflation. However – and despite the more aggressive approach to tightening we expect tomorrow – the near-term outlook for SEK remains quite clouded given its high exposure to the unstable risk environment - including most recently its looming entry to NATO. Even in the event of a hawkish surprise today, we struggle to see EUR/SEK sustaining a break below 10.60.

A stabilisation in sentiment in the latter part of the year may be the trigger for EUR/SEK to re-connect with short-term rate dynamics, which clearly point to a much stronger SEK. We still target a return to 10.10-10.30 by year-end.

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