

## FX Daily: Activity currencies remain under pressure

Wednesday was another bad day for equities where the MSCI World equity index fell another 3%. The fact that expectations for Fed policy tightening remain intact is a sign that investors appreciate that tackling inflation is now the priority for central banks. This continues to favour the anti-cyclical dollar, but also now the Japanese yen



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### USD: The cavalry ain't coming

Yesterday saw the S&P 500 sell off 4%, led by consumer stocks. The fact that some of the biggest main street names are under pressure on the back of profit warnings is a reminder that the squeeze on real incomes is starting to hit home. Over prior decades, decades associated with very dovish Fed policy, one might have expected this magnitude of an equity market sell-off to put a dent in Fed tightening expectations - or expectations that the Fed would come to the equity market's rescue. In fact, the Fed funds futures strip barely budged yesterday. We read this as a sign that investors now appreciate that tackling inflation is the number one priority of the Fed - and the Fed will not easily be blown off course.

At the same time, we are still only hearing concerns from Chinese policymakers about the slowdown, rather than any promise of major fiscal support. And one could argue what would be the use of major fiscal support if workers and residents remain trapped in Covid lockdowns? For that reason, it seems very difficult to argue that renminbi depreciation has run its course and we cannot rule out USD/CNY pushing through the 6.80 area over coming weeks and months.

This all leaves the anti-cyclical dollar quite well supported. We had made the case [on Tuesday](#) for a selloff in the overbought dollar. That correction did not last long and again it is hard to rule out the dollar edging back to recent highs. Not until the Fed blinks on policy tightening or the rest of the world's growth prospects start to look attractive - neither of which seem likely over coming months - will the dollar put in an important top.

For today, the US calendar is light with just initial claims and existing home sales for April. Housing looks to be [one of the most vulnerable sectors](#) of the US economy, but its slowdown (and its effect on dragging core inflation lower) looks a story for much later in the year.

DXY has seen a modest bull market correction this week, but can probably edge higher to 104.10 today.

## ➔ EUR: ECB will have to talk a good game

Providing the euro a little support this week has been even more hawkish commentary from the European Central Bank. We had felt that the market would struggle to price in more than 75bp of ECB tightening this year, but central bank hawks such as Klaas Knot have introduced the idea of the ECB moving in 50bp increments. This has helped narrow the two-year German Schatz-US Treasury spread to 225bp from recent wides at 250bp and provided some modest support for the dollar. This can be seen as verbal intervention from the ECB to support the euro. An important policy paper from the ECB a few years ago concluded that two-year rate differentials were the most significant driver of EUR/USD and the ECB's best hope of stabilising EUR/USD may indeed be to talk up prospects of the forthcoming tightening cycle.

For today, look out for the minutes of the April ECB meeting, where again it might choose to emphasise the more hawkish elements. EUR/USD has had its oversold bounce to 1.0550 and with the global environment remaining challenged, EUR/USD could today drift back through 1.0450/60 to 1.0400.

Elsewhere, we note some short-term similarities between both the Swiss franc and the Czech koruna. The central banks behind both currencies would prefer stronger currencies to play their role in delivering stable/tighter monetary conditions. We conclude that EUR/CHF upside may be more limited - and the downside more open - than most believe. While for EUR/CZK, the Czech National Bank (CNB) will want EUR/CZK to continue trading under 25.00 and perhaps lower still - until at least 1 July when a new CNB governor takes over.

## ➔ GBP: One month realised volatility at 8%!

EUR/GBP one month realised volatility is back at 8% - which is very high for a European FX pair. Expect this volatility to continue given much uncertainty about the policy path for both the Bank of England (BoE) and the ECB. Here, we happen to think that tightening cycles in both are over-priced and one would probably think that the BoE cycle gets repriced lower first.

Expect EUR/GBP to continue to trade in a very wide 0.8400-0.8600 range, while cable looks more one-way traffic. We have seen the bear market bounce to 1.2500 this week and the difficult external environment would favour a break of 1.2330 support in a move back to the 1.22 lows.

## 📌 ZAR: SARB expected to hike 50bp today

The South African Reserve Bank (SARB) is widely expected to hike 50bp to 4.75% today. The policy rate is quite low by emerging market standards, but that is because core inflation is only running at 3.9% year-on-year. A 50bp hike looks unlikely to generate much support to the rand, which is currently being re-priced off of the Chinese growth cycle. With \$70bn of portfolio capital having left emerging markets since Russia invaded Ukraine - and with South Africa having large weights in emerging market debt and equity benchmarks - we expect the rand to stay under pressure for the time being.

16.35 is big resistance for USD/ZAR, above which 17.00 beckons for later in the year. Rising US real yields and the China slowdown continue to make the bear case for emerging markets.

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