FX Daily: All in on 50bp bets!

The dollar has started the week on the front foot and may remain supported in the coming days as markets continue to heavily bet on multiple 50bp rate hikes by the Federal Reserve in 2022. Payrolls on Friday may fuel hawkish expectations further, and we could see EUR/USD slip to 1.08 and USD/JPY push through 125

USD: Hawkish repricing prompts 5Y-30Y curve inversion

Diplomatic tensions between Nato members and Russia remain quite elevated, and were exacerbated over the weekend after Biden's remarks against Putin had to be followed up by multiple clarifications that the US is not seeking a regime change in Russia. For markets, the focus remains on how much these tensions can spill over onto the energy commodity market, and lingering uncertainty in this sense could continue to favour commodity currencies like Norway's krone and the dollar bloc, and leave European currencies vulnerable.

We think the dollar can find more support this week, as markets may continue to speculate on multiple 50bp rate hikes by the Fed in the remainder of the year. Investors are probably just expecting some confirmation that the US jobs market has remained tight to cement their hawkish views: this week we'll see the Jolts opening data first, and the ADP and official payrolls later. Our US economist expects the headline nonfarm payroll number to come in at 500k, which should be enough to support expectations around 100bp of tightening by June – which is also our house call.

The 5Y-30Y portion of the US yield curve has inverted for the first time since 2006 on the back of sharply rising front-end yields, a dynamic that should offer more support to the dollar. We think DXY can continue to advance in the coming days and test 100.00, with European currencies and the yen still likely to be the main victims.

EUR: Inflation readings this week might not help much

The highlight of this week in the eurozone will be the inflation readings (on Wednesday and Thursday) for the month of March, where another acceleration is widely expected. Market consensus is for the headline rate to break well above 6.0% in Germany and reach 6.7% in the eurozone, with the core rate possibly breaking above 3.0%. We suspect that markets are almost fully pricing in the increase given the impact from the Ukraine war on energy prices and supply chain disruption, and considering that 100bp of ECB tightening is already factored into money market expectations for the next 12 months, the inflation readings may not prove enough to offset the still negative external environment for the euro this week.

Accordingly, we could also continue to see a quite contained EUR impact from a few ECB speakers this week: Olli Rehn today, Christine Lagarde, Philip Lane and Luis de Guindos later this week. We still see mostly downside risks for EUR/USD in the short-term, with a move to 1.0800 looking likely by the end of the year.

GBP: External drivers should prevail

The UK data calendar this week is rather quiet, and the pound should be mostly driven by external factors after today when we'll hear from the Bank of England's Governor Andrew Bailey and from Chancellor Rishi Sunak in his testimony to parliament.

We continue to see the euro as more exposed to any dollar strength given the higher sensitivity to energy prices and greater monetary policy divergence with the US, although EUR and GBP have indeed moved in tandem in recent weeks and EUR/GBP may not weaken much more below the 0.8300 mark for now.

Cable, instead, may well extend its current downtrend towards the key 1.3000 support that it briefly tested in mid-May.

JPY: BoJ "failed" intervention adds pressure to the yen

The Bank of Japan intervened in the bond market announcing two unlimited buying operations to keep 10Y JGB yields below the top of its yield curve control tolerance band (0.25%), but that has so far failed to send yields lower and has added pressure to the yen.

We think a move by 125 is USD/JPY is a matter of 'when' rather than 'if' given the bond market weakness on the back of rising Fed tightening expectations and rising energy prices, which are a negative for the export-dependent Japanese economy. Upside risks should continue to prevail even beyond 125 and 130 is well within reach in the near term unless the bond environment improves.

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