

## FX Daily: All in on 75bp bets

Markets are fully pricing in a 75bp rate hike by the Fed tomorrow, and we acknowledge this is looking to be an increasingly likely scenario. At this stage, we cannot exclude the implied probability of a 100bp move to start rising, too. All this should limit the size of any dollar correction today if market sentiment shows some recovery



We have published our monthly FX update for June. More details in "[FX Talking: Summer of discontent keeps dollar in demand](#)".

### ⬇️ USD: 75bp in the bank, now 100bp?

Inflation fears continued to rock equities yesterday, sending the S&P 500 into bear market territory and generating another flight to safety in global markets. This morning, European and US stock futures are trading in the green, signalling a potential pause in the sell-off after three terrible days for risk assets.

In FX, the dollar has emerged as the clear winner in the current environment, trading somewhere between 2.1% and 4.7% higher against G10 currencies compared to last Tuesday. In periods of

rapidly deteriorating market sentiment, G10 FX performance tends to be increasingly correlated with the liquidity conditions of each currency. It is something that became evident during the spring 2020 downturn, and more recently during the April/May equity correction. The least liquid currency in the G10 is Norway's krone, which tends to be the worst performer during market turmoil. Canada's dollar, meanwhile, has better liquidity conditions than other pro-cyclical currencies and has indeed performed less poorly than other commodity currencies in the past week.

Needless to say, the dollar is by far the most liquid currency in the world, and in a fully-fledged flight to safety, it emerges as a more attractive defensive trade than other safe-havens like the Japanese yen and Swiss franc. And even more so at the current juncture, when the equity sell-off is being accompanied by a bond sell-off, which would generally have a negative impact on low-yielding currencies. The yen is also facing the FX intervention dilemma and a central bank that is struggling to keep domestic rates in line with its yield curve control target. We discuss more in the JPY section below.

At the same time, the dollar strength continues to be fuelled by a re-pricing higher in Fed rate expectations. Markets have rushed to rapidly price in a 75bp rate hike by the Fed tomorrow, now attaching a nearly 100% implied probability to this scenario. We acknowledge 75bp is looking increasingly likely and at this stage, it is not to be excluded that investors will continue to push their expectations even higher, and start considering a 100bp hike. The market-implied terminal rate for mid-2023 is now some 10-15bp above 4.0%, having risen around 70bp since last Thursday (before the US CPI report).

All this surely paves the way for a dollar correction tomorrow if the Fed sticks to its plan to hike by 50bp, but also shows that markets are increasingly comfortable with very hawkish Fed pricing, and evidence of sticky inflation over the coming months may well keep such hawkish pricing – and by extension, the dollar – well supported even if equities start to recover.

There's only the NFIB small business sentiment and PPI figures to keep an eye on today: expect little market impact. We think the dollar may well face a mini-correction today if indeed the risk slump pauses, but the underlying narrative of hawkish re-pricing in Fed rate expectations should limit the magnitude of such a correction. DXY should hold above 104.00 into the FOMC meeting tomorrow.

## **EUR: All eyes on the ZEW**

The euro is the second most liquid currency in the G10, which makes it somewhat less vulnerable than other pro-growth currencies to the current slump in global risk assets. That said, we think that markets will remain reluctant to re-enter bullish EUR/USD positions en masse despite the seemingly attractive levels given: a) the support to the dollar offered by the sharply rising hawkish bets on Fed tightening and b) the significant widening in the eurozone's peripheral spreads. Yesterday, the 10-year BTP-Bund spread touched 240bp (nearly 40bp wider than a week ago) as Italian yields broke above 4.0% for the first time since 2014.

Today, the German ZEW will be watched closely as the consensus expects some improvement in both the expectations and current situation surveys. This is unlikely to materially mitigate the market's concerns about the upcoming slowdown in the eurozone economy, but may help EUR/USD climb back to 1.0500 if risk sentiment stabilises.

On the European Central Bank side, we'll hear from Isabel Schnabel, one of the central bank's most hawkish members. Still, it will mostly be down to global sentiment to drive EUR/USD moves today.

Elsewhere in Europe, Swedish inflation data surprised on the upside, with CPIF jumping 7.2% year-on-year and CPIF excluding energy up 5.4% YoY. We believe this materially increases the risk of a 50bp rate hike by the Riksbank at the 30 June meeting.

## ⬆️ GBP: Not much impact from Brexit headlines

The Brexit factor is about to re-emerge for sterling, as PM Boris Johnson published a plan yesterday to give ministers the power to unilaterally suspend parts of the Northern Ireland Protocol between the UK and the EU. Such a move would most likely trigger an automatic retaliation by the EU in the form of tariffs and other export duties.

This is surely a thread to keep an eye on as it might exacerbate the ongoing bad momentum for sterling. However, global market conditions are likely to overshadow the Brexit factor for now, and cable may correct slightly higher (to the 1.2250-1.2300 area) today if risk sentiment takes a breather.

On the data side, [UK jobs data showed a slight increase](#) in the unemployment rate and a flattening of wage growth. We can't read too much into the data at this stage, as the UK labour market undoubtedly remains tight. However, such tightness is not enough to justify the more than seven BoE rate hikes priced in by the market. We see predominantly downside risks for GBP as the [BoE announces policy on Thursday](#).

## ⬇️ JPY: BoJ under attack

The Bank of Japan continued to intervene in the bond market as speculative bets tested the Bank's tolerance. This time, the BoJ stepped into super-long maturities as well, which are a more vulnerable part of the yield curve as they are not "protected" by an official YCC target like the 10-year tenor. With the Fed now looking more likely to hike by 75bp than 50bp at tomorrow's meeting, it is surely possible to see additional pressure on JGBs and indirectly on the BoJ to start unwinding its huge monetary stimulus.

A hawkish shift would also help stabilise the yen, but the central bank has so far reiterated its ultra-dovish commitment. This means that the yen remains vulnerable, especially if some stabilisation in risk sentiment lifts safe-haven support to the currency and leaves it exposed to the evidence of sharply rising yields and hawkish Fed tightening. We continue to flag the elevated risk of USD/JPY breaking significantly above 135.00 in the coming days unless Japanese authorities step in with FX intervention.

## Authors

### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

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