

FX Daily: Bank of England rate protest hits the pound

Upward revisions to inflation and downward revisions to growth forecasts remain the dominant global theme – a theme clearly evidenced in the BoE's communication yesterday. The net result is a negative one for risk assets and a positive one for the dollar. US average earnings may be the most important data point today. Expect the dollar to stay bid



UK growth should be volatile in the months ahead

USD: Price pressures in focus in the NFP report

The dollar remains very much in demand around the world as price pressures increase, but growth prospects are revised lower. Nowhere was that clearer than in the UK yesterday, where the [Bank of England](#) (BoE) forecast a UK contraction in 2023 and revised the 2022 peak in inflation. The BoE update also included an implicit 'rate protest' against market pricing of tightening prospects – a measure that hit the pound.

This late-cycle, stagflationary environment is a negative one for risk assets, where the S&P 500 was off 3.5% as US yields returned to their highs. At the same time, investors remain concerned about European and Asian growth prospects. USD/CNY is today pushing to a new cycle high and

the uncertainty about what the People's Bank of China (PBoC) wants to do with its exchange rate is a global source of volatility and a negative for emerging market currencies in general. Notably, those currencies most highly correlated with China, such as the South African Rand, Brazilian real and Australian Dollar, were hit the hardest yesterday.

This all raises some interesting questions for the Federal Reserve. Yet the pricing of the Fed tightening cycle remains rock-solid (terminal rate priced at 3.30% next year) and one of the big differences between the Fed and the BoE is that US inflation is more domestically generated from tight labour markets and the huge fiscal stimulus seen over recent years. Following last week's US Employment Cost Index shock, we suspect the key focus in today's US Non-Farm Payroll report will be the average weekly earnings numbers and the unemployment rate. An average hourly earnings number in line with consensus (0.4% month-on-month, 5.5% year-on-year) should keep US yields and the dollar firm. Any soft headline employment data will be ascribed to tight labour markets.

We also have several Fed speakers today, including Williams at 15:15 CET. We expect the dollar to remain bid and DXY to remain pressing the 104.00 area.

Elsewhere, labour data will also be released in Canada today. While a modest slowdown from March's 70k increase in employment is expected (consensus is around 40k today), the release should prove broadly supportive of the Canadian dollar. We also see some risk of an above-consensus read today given the strong demand backdrop, the positive implications of higher commodity prices for Canada's oil and gas industry and apparently fewer labour constraints than in the US. The balance of risk for CAD today is slightly tilted to the upside, though our preference for USD/CAD trading sub 1.25 in 2H22 will require some calmer international conditions.

⬇️ EUR: ECB hawkishness being drowned out

Hardly a day goes by without another hawkish ECB member airing expectations for earlier tightening. Overnight ECB hawk Robert Holzmann has said that the ECB will discuss hiking at its June meeting – the same month in which asset purchases end. So much for sequencing! Our team now forecasts ECB hikes in [July, September and possibly December](#), but, as they note, a December hike could prove an ex-post policy mistake akin to Jean-Claude Trichet's hike in September 2008.

Given that around 90bp of ECB tightening is already priced by year-end, we do not think a further round of ECB hawkish talk is enough to provide much support to EUR/USD. Instead, the Fed story and weak growth in Europe and China are likely to see EUR/USD trading on the soft side of a 1.0500-1.0650 range, with risks skewed towards a break down to the 2016 lows of 1.0350. As we discuss in [ING's monthly global update](#), the prospects of EUR/USD trading parity by year-end is a [one standard deviation proposition](#) – and should not come as a shock.

Elsewhere in Europe today, look out for a National Bank of Poland (NBP) press conference today at 15:00 CET. The NBP hiked [slightly less than expected yesterday](#), but we expect a hawkish press conference and now see the policy rate heading to 8.5% at the end of the year. EUR/PLN should trade back to 4.60 at the first sign of international conditions starting to settle.

⬇️ GBP: BoE rate protest hits the pound

Sterling fell sharply yesterday after the BoE signalled a 'rate protest' to market pricing of its tightening cycle. This came in the form of a three-year CPI forecast at 1.45% assuming market

pricing for the policy rate. 1.45% is naturally well below the BoE's 2% medium-term target for inflation. Investors immediately lopped 25bp off their expectations for the cycle.

Signs that the BoE may be close to the top of its tightening cycle (two of the nine Monetary Policy Committee dissented against further hikes) suggest sterling may be vulnerable as trading partners including the US and the eurozone push ahead with tightening cycles. This month we are raising our year-end EUR/GBP forecast to 0.86 from 0.84. The 200-day moving average near the 0.8450 area may now prove good EUR/GBP support, with a bias towards 0.86 now.

➔ CZK: Another hawkish surprise from the CNB, but the koruna story remains unchanged

Czech National Bank yesterday raised its key rate by 75bp to 5.75%, surprising the market by 25bps to the upside. At the same time, the central bank's new forecast expects rates to rise well above 8%. However, Governor Jiří Rusnok also presented an alternative scenario, preferred by the board, with a shifted monetary policy horizon from 2023 to 2024 and implies a peak in rates below 6%, which is the current level and a later rate cut compared to the baseline scenario.

Although we do not see the situation as hawkish, the market has reacted with a sharp rise in market rates. As a result, the interest rate differential moved up by about 25bp after yesterday's meeting. Even so, it did not erase the decline caused by the rise in core rates and the koruna's story remains unchanged in our view. The strong dollar, rising core rates and persistent risk aversion will continue to prevent a more significant appreciation and we continue to expect the koruna to remain in the 24.30-24.50 range.

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