

FX Daily: Beware of short-lived rallies

Some stabilisation in risk sentiment after yesterday's equity sell-off could help high-beta currencies recover some ground today. The dollar might feel some pressure, although buy-the-dip interest may emerge given the backdrop of Fed tightening, growth concerns and an unstable risk environment. The illiquid NOK may struggle to recover just yet



We have published our monthly FX update, for more details see: ["FX Talking: Feeling the squeeze"](#)

⬇️ USD: Any weakness looks unlikely to last

Global equity futures are pointing to a tentative rebound in global risk assets today after a major sell-off yesterday triggered by fears of an economic slowdown at a time when central banks are tightening policy. It is not surprising to see the dollar remain strong in such an environment, retaining its safe-haven attractiveness whilst still benefiting to a certain degree from the Fed's front-loaded tightening story. It is also quite predictable to see high-beta currencies bear most of the brunt in the current market conditions: liquidity considerations could be behind the Norwegian krone's exceptional underperformance (more in the section below), while concerns over China's economic outlook continue to weigh on the Aussie and New Zealand dollars.

Low-yielding currencies, including the pro-cyclical euro and pound, seem to be finding some favour from the markets, although prolonged market volatility and instability in sentiment look unlikely to generate any other winners outside of the dollar or the traditional safe-havens (Japanese yen and Swiss franc). Yesterday, the Fed sounded the alarm on worsening liquidity conditions across key markets and warned of the increasing risk of a “sudden material deterioration”. Historically, tighter financial conditions tend to raise demand for dollars.

It's a quiet day in the US calendar today, with some focus only on the NFIB Small Business Optimism survey for April. There are, however, a number of Fed speakers scheduled this afternoon: the “neutral” John Williams and Tom Barkin, the dove Neel Kashkari and the hawks Loretta Mester and Christopher Waller. The impact of any policy comment might, however, be reduced as markets may wait for tomorrow's CPI figures before any material re-adjustment in the Fed's rate expectations.

We think risk sentiment will drive almost all FX moves today. A risk-on rebound may be on the cards after yesterday's slump, and commodity currencies may recover some ground, to the detriment of the dollar. Given the general instability in the global risk environment, some interest in buying the dip in the dollar should remain high and we do not expect any sustained USD underperformance in the near term.

EUR: Eyes on ZEW and ECB speakers

EUR/USD is once again attempting to find some support in the upper half of the 1.05-1.06 range. Some resilience amid yesterday's turbulent market conditions and a potential stabilisation in risk sentiment today could combine to fuel a break above 1.0600 today. Still, the upside remains limited – in our view – given some USD buying and lingering concern about the ban on Russian oil currently under discussion in the EU. Hungary's opposition is the key hurdle at the moment, and talks between Brussels and Budapest are set to resume today after President Orban opposed the embargo despite the EU allowing more time for Hungary to comply.

On the data side, markets will focus on ZEW figures out of Germany today. Both the “expectations” and “current situation” surveys are set to show another drop in May given high energy prices and the prolonged geopolitical risk. However, the impact on EUR/USD of the latest ZEW releases has been quite negligible.

There are also a few ECB speakers to keep an eye on today, as markets now appear to cement their expectations around a July hike (which is also our base case) but remain torn around the size of rate increases in 2022. One of the most hawkish members of the Governing Council, Germany's Joachim Nagel, will speak first this afternoon, followed by the more moderate François Villeroy and Luis De Guindos.

We see some modest upside risk for EUR/USD today, with any rally possibly stalling already around the 1.0650 level.

GBP: Seeking more stability

The pound is finally finding some stability after a rough couple of weeks. Some stabilisation in sentiment should offer additional support today, and possibly help a return to the 1.2500 mark in GBP/USD.

Still, the market's overly hawkish expectations on Bank of England tightening and uncertainty around the British economic outlook are set to keep GBP/USD capped in our view. We have a 1.2400 target for cable for the summer months, followed by a very gradual recovery in 2H22.

The UK data calendar is empty today, and there are no scheduled BoE speakers.

NOK: Liquidity is an issue

The Norwegian krone is finding some modest support this morning, following a general rebound in high-beta currencies and some above-consensus CPI figures in Norway, which showed an acceleration in headline inflation to 5.4% and in the core rate to 2.6%. The release endorses our view that Norges Bank will bring interest rates to 1.50% by year-end, with risks skewed towards an even faster pace of tightening.

The domestic backdrop is therefore set to remain quite supportive for NOK, and so should the commodity picture – especially if the EU implements the Russian oil ban. However, NOK is the least liquid currency in the G10, which makes it exceptionally vulnerable and volatile during periods of risk sentiment turbulence. Until risk assets find some peace, despite monetary tightening and global slowdown concerns, NOK will struggle to recover.

Once the dust settles, however, NOK's set of attractive fundamentals should fuel a gradual return to the 9.50-9.70 area – which we expect to materialise in the second half of the year.

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