FX Daily: Big central bank day amid geopolitical volatility

We expect a 25bp cut in Switzerland, and holds in the UK, Norway and Turkey. But the main driver for FX remains the Middle East situation and implications for oil prices. The dollar is likely to remain in a strong position to extend its gains, although we doubt this will translate into long-term USD support

The Bank of England will almost certainly keep rates on hold today

USD: Still upside risks

The two major US macro events yesterday (the FOMC and TIC data) left very few marks on FX. As discussed in our Fed review, markets are understandably attaching limited value to dot plot projections given the high uncertainty of the tariff impact and recent oil volatility. And while keeping two rate cuts in the 2025 median projection may seem moderately dovish, the Fed sounded less concerned about growth and unemployment.

Right after the Fed announcement, TIC data showed the unwinding of foreign US treasury holdings in April was quite contained (a decline of just $36bn out of $9tr). That suggests a greater role of domestic investors in the Treasury sell-off than the “sell America” theme might have suggested. Anecdotal evidence in de-dollarisation remains significant, and at least another month of TIC data is needed to get a clearer picture. However, the dollar likely dodged a bullet with yesterday’s figures, and the lack of conclusive evidence of foreigners' exodus from Treasuries can make markets slightly more cautious in building additional risk premium on the dollar.

Anyway, the short-term dominating driver remains geopolitics. Media reports are now strongly suggesting the US is preparing to directly attack Iran, perhaps as early as this weekend. The whole foundation of the high USD risk premium (i.e. short-term overvaluation) was the theme of US self-inflicted damage; and while that has seriously dented USD safe-haven appeal, the combination of geopolitical risks and high oil prices is not US-induced risks, and therefore the dollar is still in a more favourable spot than the energy-dependent safe-haven alternatives (like the euro) in this environment. Upside risks for USD persist.

Francesco Pesole

EUR: Lots of central bank activity in Europe today

Our view is that EUR/USD can probably correct a bit further from here on geopolitical risks. Our near-term target is 1.140, and explorations below that level can be justified even without new big spikes in oil prices. That said, geopolitical events tend to be temporary drivers for FX unless they trigger long-lasting effects on commodity prices (like the Russia-Ukraine war). So, we still think there will be plenty of interest in buying the EUR/USD dips at the first signs of de-escalation.

Aside from speeches by ECB President Christine Lagarde and other Governing Council members today, the eurozone calendar is empty. However, there is plenty of action in the rest of Europe, with central bank meetings in Switzerland, Norway and the UK.

We expect the Swiss National Bank to cut rates by 25bp to 0%, and to leave the door open for another reduction. Markets are pricing in 31bp for this morning and almost fully pricing in another cut by year-end. The initial CHF reaction may be slightly positive, but we think that a reinforcement of expectations for negative rates will curb gains.

In Norway, Norges Bank will likely keep rates on hold, as markets price in no chance of a move today. We argued here that policymakers are taking some risk in continuing to delay easing, and that a cut in August would be appropriate. However, the new spike in oil prices means the new projections may not signal a move before September – which is fully priced in. EUR/NOK may remain capped on a still hawkish tone.

Finally, the Bank of England will almost certainly keep rates on hold, in line with consensus and market pricing. As discussed in our preview, there could be more than one dissenter voting for a cut, but the overall guidance should remain broadly unchanged, roughly endorsing market expectations for two more cuts by year-end. The risks are however slightly on the dovish side given the recent slew of soft UK data, and we remain bullish on EUR/GBP in the near term.

Francesco Pesole

CEE: Fed doesn't change the picture but the Middle East remains a risk

CEE currencies have been in limbo so far this week awaiting the Fed and more clarity on the situation in the Middle East. Yesterday's Fed tone doesn't seem to have affected the direction of the CEE much and the path from this point may be easier. The escalation in the Middle East is affecting the CEE region mainly through the oil and gas price channel. Another price shock is bad news as inflation is rising again in most places in the region. Central banks thus have extra reason to worry about higher inflation numbers in the coming months. As discussed previously, we see Hungary and the Czech Republic most exposed due to their openness and dependence on energy imports. At the same time, both central banks are keeping a close eye on any print that has produced an upside surprise in recent months. Thus, a potential further rise in oil prices may be the final reason for central banks not to cut rates at all this year.

If the conflict escalates and keeps impacting energy prices, we see more room to pay front-end rates in HUF and CZK despite the current high levels. For FX, this implies an attractive risk-reward. Although further escalation may initially lead to a risk-off mood and weakening of EM currencies, including the CEE region, higher inflation and hawkish central banks could eventually drive FX to stronger levels. On the other hand, PLN seems more isolated due to the strong local story. Moreover, PLN has underperformed CEE peers in recent weeks and should be more resistant. At the same time, higher rates due to a hawkish central bank point to EUR/PLN below 4.240.

Frantisek Taborsky

TRY: Despite the upcoming restart of the cutting cycle, fat carry remains

We expect the Central Bank of Turkey to leave rates unchanged today at 46% in line with market expectations. The CBT has started easing liquidity conditions to normalise the average funding cost around the one-week repo rate. This leads to a decline in CBT funding costs to 46% from 49% ahead of today's meeting. Given this backdrop, we think the bank will wait for the July meeting and another inflation print to start cutting the policy rate.

Regardless of the story, TRY remains the leader in carry within the EM space and our favourite currency. USD/TRY remains on its usual upward trajectory with some downside spikes in the last few weeks, however it is clear that FX policy remains unchanged for now. At the same time, we do not expect any changes in the coming months, and after the March TRY sell-off we believe the CBT is committed to keeping FX under control at least through the period of the cutting cycle restart. Therefore, the period at least until the end of summer should be safe for TRY longs. Looking ahead, we expect USD/TRY to move to 41.27 at the end of September and 43.00 at year-end.

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