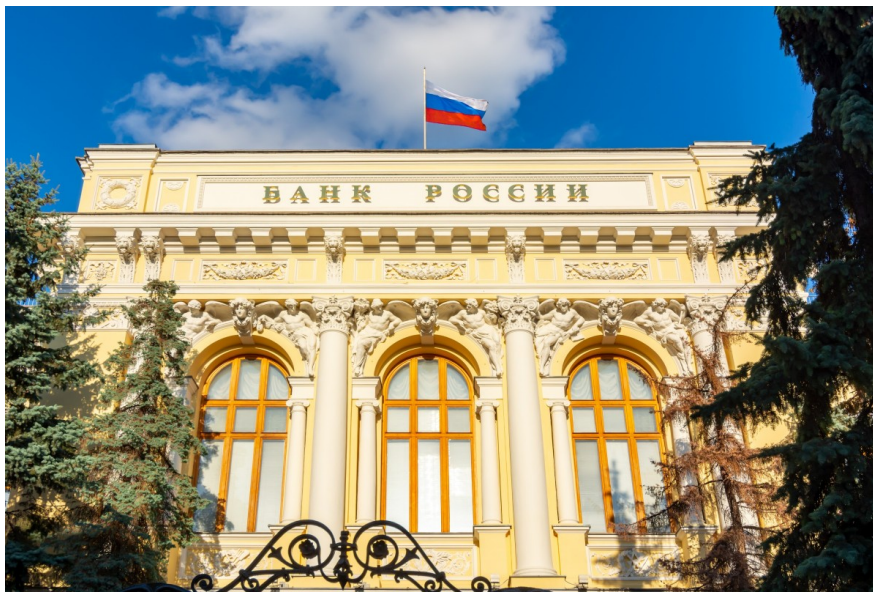


FX Daily: Russia set to cut rates further today

A hawkish set of FOMC minutes and ongoing concerns about Chinese growth prospects continue to provide the dollar with support and make for an uneasy environment for risk assets. The US data calendar is light today, but the focus will be on new fiscal support measures in the UK funded by a windfall tax, plus rate meetings in Russia and Turkey. Dollar to stay bid



Central Bank of Russia building in Moscow.

USD: Hawkish set of FOMC minutes should keep the dollar supported

Reading through the release of the 4 May FOMC minutes suggests that, at that time, the Fed had nothing but confidence in the recovery and was laser-focused on getting the policy rate to neutral as quickly as possible. Indeed, there was some slight reference for the need for the policy rate to go beyond neutral and into restrictive territory. Since then US equity markets have fallen a further 8-9%, with some softening in the housing data. However, the Fed seems confident with the consumption and investment story. And tomorrow's personal consumption and core PCE deflator numbers for April should support the Fed's position that the economy is strong enough to

withstand 'expeditious' tightening.

Pricing of the Fed tightening cycle has corrected 25-35bp lower since early May, but Fed speak and the US data calendar suggests those higher levels for the Fed terminal rate could easily be put back into the market - which is dollar supportive. At the same time, Chinese authorities have yet to unveil any bazooka-style support for the economy and instead are relying on a lot of local targeted measures. We do note some return of foreign portfolio flows into Chinese equity markets, but the renminbi recovery has stalled at 6.65/USD and could easily weaken again as authorities prefer a weaker currency to stimulate growth. The soft renminbi environment will continue to favour the dollar.

We prefer to see the recent DXY 3% dip as a bull market correction and favour a near-term recovery to the 103.30 area as the Fed cycle is re-priced higher again. We doubt today's US data of the revised 1Q GDP number, initial jobless claims or pending home sales will have much say in dollar pricing.

➔ EUR: Lagarde brings the ECB back into line

It seems the purpose of President Christine Lagarde's blog on Monday was to bring the range of ECB views back into line. Yesterday we saw ECB hawk Klaas Knot saying that he fully supports the contents of Lagarde's blog, which effectively promised 25bp hikes in July and September. The market currently prices 32bp of rate hikes for the 21 July ECB meeting and we may see that gravitating back to 25bp over the coming weeks.

EUR/USD looks to have stalled at the top of a potential 1.02-1.08 trading range this summer and we could quite easily see a near-term move back towards the 1.0500/1.0550 area as the Fed cycle is repriced higher. We struggle to see the ECB 'out-Fedding' the Fed when it comes to tightening - even though the ECB seems to be using the prospect of aggressive tightening to support EUR/USD. Two-year German-US spreads have narrowed into 215bp from a wide of 254bp in April, but this narrowing may have come far enough for the time being.

Elsewhere in Europe, the Hungarian forint is under pressure as the new Orban government announces a state of emergency to enact new policies. Addressing twin deficits is a key priority for the Orban government. How the government chooses to address the budget deficit - e.g. what kind of taxation - looks to be posing challenges for the forint. There is outside risk that EUR/HUF trades back to 400 again and that the National Bank of Hungary has to respond with even higher rates.

⬆️ GBP: £10bn fiscal stimulus could help the pound

The focus in the UK today is on the potential announcement from Chancellor Rishi Sunak (at 1230CET) of a £10bn fiscal stimulus to address the cost of living crisis. This could be a means-targeted measure coming through energy bills. What could this mean for sterling? The positive could be that it allows the Bank of England (BoE) more freedom to hike. The market currently prices the BoE bank rate at 2.13% for December (which is already quite high). The negative could come through the equity channel where the windfall tax on oil, gas and electricity suppliers could deliver UK equity underperformance.

We prefer the former factor dominating and EUR/GBP trading back towards the lower end of a new 0.8450-0.8600 trading range.

📌 RUB: Russia set to slash rates again

The Central Bank of Russia (CBR) has announced an emergency monetary policy meeting for today. There is widespread speculation that a large rate cut is coming in response to the stronger rouble. Recall that the emergency rate hike to 20% in February was designed to support the rouble and protect banks from an outflow of rouble deposits. In fact, the capital controls introduced by Russia and the powerful current account surplus (US\$96bn year-to-April) have generated a much stronger rouble - and one that hits expected government revenues and the fiscal position.

This week has already seen Russian authorities try to address the strong rouble by softening domestic capital controls. Russian exporters are now required to sell 50%, instead of the prior 80%, of FX export earnings within a 60-day period. Our Russian economist, Dmitry Dolgin, is looking for a 200-300bp CBR rate cut today to take the base rate to 11-12%. This large cut should be aided by signs that inflation expectations are falling and in an effort to soften what Dmitry thinks will be a 10-15% fall in Russian GDP this year.

As to the rouble, Dmitry thinks USD/RUB will be ending the year around 75 as the partial or potential total EU embargo on Russian oil hits in 2H22, while at the same time Russian resident demand for FX and imports start to stabilise. Before then, however, and because USD/RUB is mainly being driven by Russian commercial flows, a large rate cut may not send the rouble too much lower in the near term.

Authors

Chris Turner

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

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person

for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.