

FX Daily: Last hurrah from the Czech National Bank hawks

Recession fears are growing as central bankers slow demand to curb inflation. Pro-cyclical currencies are on the back foot and the dollar remains very much in demand. These trends should remain in place today as Fed Chair Powell delivers monetary policy testimony to the Senate. Also, look out for a large and probably final rate hike in this cycle from the CNB



USD: Powell sticks to his hawkish script

The narrative in financial markets seems pretty clear. Inflation needs to be addressed and given that supply-side factors show no signs of easing, central banks are going to have to take the steam out of demand by tightening monetary policy. Whether that slowdown turns into a soft-landing or a recession remains to be seen. In response, equity markets remain under broad-based pressure as growth forecasts are cut and the risk-free rate rises. Commodity prices (having caused a lot of the inflation) would also probably be a lot lower now were it not for the supply shock of the war in Ukraine.

So far the Fed remains firmly set on its hawkish course. Richmond Fed President Thomas Barkin summed things up well yesterday when he said that the Fed should raise rates as fast as possible

without breaking anything. It does not seem that the Fed considers the 21% year-to-date decline in the S&P 500 as representing anything being broken and the Fed's current rhetoric is that the US economy can handle higher rates. Expect this message to be communicated again at 1530CET today when Powell delivers his semi-annual testimony to the Senate. The Fed's terminal rate priced for 2023 is currently near 3.60% (off a recent high at 3.90%) and could go higher again on Powell's testimony. Presumably, that should see some bearish flattening of the US yield curve - which is a dollar positive.

DXY could drift towards the 105.00/105.50 area on a hawkish Fed and a difficult international environment that is seeing Asian FX come under pressure again.

➔ EUR: Consolidating near the lows

It seems that EUR/USD is happy to trace out a 1.0400-1.0600 range for the time being, with a downside bias on the back of Fed testimony today. In this strong dollar environment and intervention taking place to support emerging currencies (especially in Asia), EUR/USD will always be vulnerable to re-allocation flows from the central bank community. For example, large dollar selling from an Asian FX reserve manager will see euro weights in FX reserves rise above benchmarks. Portfolio managers at the central bank will then subsequently go out to sell EUR/USD to rebalance portfolios. That looks the risk near term as Asian FX reserve managers do battle with a higher \$/Asia.

In Europe, growth forecasts continue to be cut and concern is growing about a sudden stop in gas supplies. Investors are also probably wary of events in the Baltics where tension over Russia's outpost at Kaliningrad is growing. Equally, doubts about how hard the European Central Bank can really stamp on the monetary brakes will keep the euro on the soft side.

Elsewhere, we should hear again from Swiss National Bank President Thomas Jordan. It seems pretty clear that the SNB's strategy is to guide EUR/CHF gently lower and a re-iteration of those comments today could see EUR/CHF pressing 1.0100.

➔ GBP: No surprises from May CPI

UK May CPI [came in as expected at 9.1%](#) year-on-year and looks unlikely to have much of a say on Bank of England pricing. That pricing remains very aggressive, with the policy rate still priced above 3.00% (assuming 175bp of hikes) for the December meeting this year. As per comments from BoE Chief Economist Huw Pill yesterday, the BoE remains prepared to act more forcefully - meaning that aggressive pricing may stay in the UK money market curve for some time.

Let us not forget as well that sterling is quite an expensive hedge. Selling GBP versus EUR on a three-month basis now costs 2% per annum - and it is not particularly clear that GBP should perform much worse than the EUR given similar challenges faced by both economies.

It is not a very fashionable view, but we suspect GBP can stay a little more supported than most expect and EUR/GBP can trace out a 0.8500-0.8600 range near term.

⬆️ CZK: One last large hike from the hawks

The Czech National Bank board meets today to set policy rates. This will be the last meeting of the board under its hawkish formulation led by Governor Rusnok. We look for [one last large hike from](#)

[the hawks](#) - in the region of 125bp to take the policy rate to 7.00%. This is in response to CPI running well above estimates and printing 16% YoY in May.

This large hike has been well telegraphed, but what happens next will be intriguing. A new and perceived dovish CNB board takes over on 1 July and holds its first policy meeting on 4 August. It seems far too early for this new board to soften monetary conditions in the face of inflation, which is peaking higher and later than the CNB had originally expected. However, the focus will be on whether the new board wants to let the Czech koruna do the talking and whether - through FX intervention - the CNB wants to guide EUR/CZK lower to the 24.50 area - somewhat closer to where CNB models had been forecasting EUR/CZK to be trading (closer to 24.00 actually).

For today, EUR/CZK should either remain flat at 24.70 or go lower if today's hike is even larger than the 125bp consensus, or if the CNB tries to engineer a lower EUR/CZK. On the rates side, June has been a graveyard for those looking to receive rates. For example, the CZK 21 x 24 month FRA has risen 150bp over the last month as global rates have surged. Yet later in the summer, we suspect interest in CNB rate cuts next year will return. We think a cut could come as early as the first quarter.

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