

FX Daily: Optimism re-priced

FX markets are being dominated by a position unwind as reflation trades continue to come under pressure. The good news is that the FOMC minutes did not show a particular urgency from the Fed to withdraw accommodation. We suspect investors will return to the commodity complex later this year, while 1.1700 may be the range low for EUR/USD this summer.



Source: Shutterstock

➔ USD: Nothing particularly hawkish in the FOMC minutes

Looking across asset markets it is clear that the reflation trades are coming under pressure. The US 2-10 year yield curve continues its bullish flattening - a move one would expect much later in an economic cycle. Commodities are generally softening and confirmation that the world economy is not a one-way recovery story comes from the news that the PBOC is considering a Reserve Requirement Ratio cut - to help lending for SMEs.

There briefly had been fears that the Fed could add to slow-down fears by pushing on regardless with its tightening plans - fears built by the aggressive Dot Plots released June 16th. Yet the FOMC minutes of that meeting released last night demonstrated a much more calm and patient tone than many had expected. Yes, a substantial majority of members noted upside risks to their

inflation projections. Yet there was no suggestion that the Fed would be rushed into tapering, let alone tightening.

So those fears of a hawkish Fed look a little premature. And we can see that in US money markets, where 1 month USD OIS rates, priced two year forwards, have this week fallen from 0.82% to 0.73%. That is not a particularly bullish story for the dollar against the low-yielders is it? And it is probably one of the reasons why USD/JPY is falling for a change and a reason that EUR/USD should not be chased too much lower.

This begs the question - what next? Does the Delta-variant spread in the US and the last shoe to drop in the reflation unwind is an equity correction? We are a little more positive than that and would back growth in 3Q and a return to pro-cyclical currencies on any further near-term weakness. For today, the US focus will be on whether initial claims fall further and we could actually see DXY handing back some of this week's gains.

➔ EUR: ECB strategy review in focus

At 13CET today the ECB will release its monetary policy strategy view. This is akin to the exercise the Fed undertook last year and resulted in the Fed's Average Inflation Targeting framework. Reports widely suggest the ECB will adopt a quasi symmetrical target - targeting inflation at 2% with occasional overshoots, rather than its current 'close to, but under 2%'. Like the Fed, an ECB preparing to run the economy hotter could point to lower EUR real rates and be negative for the EUR. For the time being, however, the markets price a very dovish ECB - no real tightening until late 23/24 - and today's announcement may not have a large impact on the EUR.

Instead as above, if the Fed cycle tightening cycle is being priced a little lower/later, EUR/USD need not necessarily drop to 1.1700. And the surprise could be EUR/USD turning back higher to the 1.1850 area.

Elsewhere, we do still like the commodity complex but acknowledge that it is a widely held, conviction call and pairs like USD/CAD may still need to move up to the 1.2630 area.

➔ GBP: Focus on BoE credit conditions survey

England's football success has yet to have any material impact on GBP - though the pair is staying reasonably bid against the EUR. At the margin one could say that the ECB strategy review should be bearish for EUR/GBP - but that's a stretch.

Look out today for the BoE quarterly credit conditions survey - providing insights on lending volumes and credit spreads. It may be too early to expect lending volumes to have picked up. Current BoE pricing of the first 10bp hike in summer 2022 and the first full 25bp hike in March 23 feel about right - although could get pushed back a bit should the current unwind of optimism continue. 0.8535-0.8615 remains the EUR/GBP range - amidst a continued fall in traded volatility levels.

➔ PLN: NBP staying patient

Poland's NBP meets today to set interest rates. Our Polish team [believe today's meeting](#) will be characterised by 1% upgrades to GDP and CPI forecasts, but also by an NBP that will not follow Hungary into early hikes. That said, we do favour the first hike as early as November this year,

which should mean EUR/PLN ends the year near the 4.38/40 region.

Should the broad-based market position unwind continue - an unwind that has hit CEE FX - a still patient NBP could send EUR/PLN up to 4.56 and possibly 4.59. Yet expect good demand for PLN to resume at that area and EUR/PLN drift back to 4.50 through the summer as the NBP starts to drop hints that it could tighten later this year after all.

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

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>.