

FX Daily: Dollar boom

The dollar is booming. Some trade-weighted measures of the dollar are now close to the highest levels since 2002. The 2022 dollar boom may well turn into a bust in 2023, but we are a long way from calling a top in the dollar now. For today, USD/CNY trading above 6.60, a dovish BoJ, the European gas crisis, and some modest 1Q GDP growth should all keep the dollar bid



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USD: Dollar booming in 2022, bust in '23?

Global events are conspiring to send the dollar a lot higher. The DXY, one version of the trade-weighted dollar, is a whisker away from the 2016 high. Above that one has to look back to 2002 for any higher levels. The Federal Reserve looks set to embark on an aggressive tightening cycle this year to stamp out inflation - and has the most cause to do that because of domestically generated inflation. War in Europe and the risk of an abrupt cut-off in Russian gas are damaging European growth prospects and local currencies, while Asia is dealing with its own growth problems and the likes of both China and Japan are still in monetary easing mode.

It is hard to see this environment changing in the next six months, meaning that this dollar boom looks set to continue. DXY closing above the 104 area could also add fresh momentum to the

move. But the Achilles Heel of this dollar rally is that the strong dollar and strong domestic demand are sucking in imports and widening the trade deficit. The US posted an advanced goods trade deficit for March at US\$125bn - yes, US\$125bn. That is a new record. One developing narrative is that rather like the 1980s, Fed efforts to stamp out inflation send the dollar through the roof and the 2022 dollar boom turns into the 2023 dollar bust if, as we suspect, the Fed might be cutting rates by the end of '23. For now, the dollar boom will very much be the story.

For today, we are surprised that the People's Bank of China has let the onshore USD/CNY trade through 6.60. This is still quite a controlled pair and earlier in the week the PBoC had expressed its displeasure over renminbi weakness by cutting the reserve requirement ratio for FX derivative contracts. An unexpected adjustment in USD/CNY is keeping USD/Asia bid - a move supported by a dovish Bank of Japan today, which kept its 0% JGB yield target unchanged and promised to buy JGBs every day (assuming it can find sellers). The dovish BoJ undermines any thought of BoJ effective FX intervention and it feels like USD/JPY would have to see some kind of disorderly move to the 135 area before the risk of intervention seriously increases.

US data today is 1Q22 GDP, expected at 1% quarter-on-quarter annualised. More important will be tomorrow's US 1Q22 Employment Cost Indicator. Expect the dollar to stay bid on the global monetary-geopolitical configuration. Closes above 104 DXY warn that this dollar rally goes into hyper-drive.

📉 EUR: 35% chance priced of EUR/USD hitting parity this year

The FX options market assigns a 35% probability to EUR/USD trading 1.00 at any time before year-end. This is up from 25% earlier this week and just 15% a couple of weeks ago. Clearly, the spot move has driven a lot of this, but so has the rising risk premium and higher volatility currently being priced into markets. Of the many concerns facing European currencies, the most pressing is an abrupt cut-off in Russian gas more broadly in Europe. Poland and Bulgaria have seen their supplies cut off after refusing to pay in roubles. It looks like Hungary and Slovakia have agreed to pay. And the Financial Times is today reporting that some German and Italian companies may be considering setting up rouble accounts with Gazprombank in order to secure gas. How this story plays out and the degree to which the eurozone economy is hit (estimates range in the 1-3% of eurozone GDP on a complete cut-off) will help determine EUR/USD levels. But for the time being, EUR/USD remains fragile and a clean break of 1.0500 opens up the 1.0350 area.

For today, look out for Germany and Spanish CPI figures for April. ECB rate hike expectations for year-end are holding up at around 72bp worth of hikes - but our team thinks that if the more bearish European gas scenarios emerge, the ECB will struggle to take the deposit rate above zero.

📉 GBP: 1.2500 is big support for cable

In the face of a powerful dollar bull trend, GBP/USD has crumbled. Big support can be found at 1.2500, similar to the big levels of 1.0500 and 130 on EUR/USD and USD/JPY. Perhaps the only thing supporting cable at 1.25 is the fact that it has come a long way quite quickly. We cannot rule out cable breaking lower, but again we think this is more a dollar than a sterling move. And assuming that the Bank of England does not cave into the dovish minority at next week's meeting, we suspect EUR/GBP can probably trade back down to the 0.8350 area.

➔ SEK: Not our base case, but the Riksbank might hike today

We have seen a radical shift in the Riksbank's rhetoric in recent weeks, as the Bank's members moved from ruling out any hikes before 2024 to implicitly signalling some tightening already this year. With the policy message shifting rapidly to the hawkish side of the spectrum on the back of rising inflationary pressures, we cannot exclude that the Riksbank will deliver a rate hike (25bp) today.

However – [as discussed in our Riksbank's meeting preview](#) – we think policymakers will use this meeting to lay the groundwork for the start of a tightening cycle in June, with rate projections that may signal a total of three hikes (June, September, November) this year and at least two more in 2023-2024. That would still leave a projected terminal rate below the 2.50% priced in by the market, but the radical hawkish turn and the Riksbank's recent tendency to be conservative in its rate projections mean that hawkish bets across the SEK curve should remain well supported.

From an FX perspective, this should translate into some more support to the krona, which has widely benefited from Riksbank tightening expectations in recent weeks. That said, unstable risk sentiment and lingering geopolitical risks affecting Europe may keep a lid on high-beta currencies like SEK in the coming weeks. We think EUR/SEK may struggle to trade sustainably below 10.20-1.30 in the current environment.

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