FX Daily: Dollar gets a lift from tariff ruling and FOMC insight

The dollar has jumped in Asia on news that a US court has ruled the majority of President Trump's tariff hikes illegal. We also found the minutes of the 7 May FOMC meeting slightly hawkish and also a little dollar supportive in that the Fed showed no evidence of foreigners leaving US asset markets and that it was just hedging driving the dollar lower in April

US President Donald Trump in Washington on Wednesday. A US court has ruled that his sweeping tariffs were illegal

USD: Trade wars can be messy

FX markets should focus on two themes today: the US Court of International Trade ruling that the majority of President Trump's tariffs are illegal, and insights from the minutes of the 7 May FOMC meeting, which suggest that dollar selling in April was driven by hedging rather than outright sales of US assets.

On the former, the dollar has rallied around 0.5/0.7% in Asia on the view that Trump may be more constrained in his trade war. This follows a court ruling that found he had exceeded his authority by invoking emergency powers to impose reciprocal tariffs in April, as well as earlier fentanyl-related tariffs on Canada, Mexico, and China. The White House is, as expected, appealing the decision.

The news that the legal system is constraining the use of tariffs has been welcomed by US equity markets, where S&P futures are up around 1.2% in Asia. Nvidia's first-quarter earnings report is also helping here. This is slightly bearish news for US Treasuries in that better US growth prospects further reduce the chance of an earlier Fed cut, but also that the assumed tariff revenue may not materialise to offset the fiscally expansionary Big, Beautiful Bill currently passing through Congress. Notably, the US 10-year US swap spread remains wide at 55bp and the risk premium in US Treasuries may be one of the factors preventing a more whole-hearted rally in the dollar.

The FOMC minutes are worth a read as they provide the Fed's take on market developments in April. They attribute the Treasury sell-off more to the swap spread (US 10-year Treasuries versus swaps) than to the basis trade (cash versus futures). The Fed also noted, based on feedback from its market contacts, that the sharp decline in the dollar was primarily driven by increased FX hedge ratios, rather than significant foreign selling of US assets. While acknowledging that global investors only change strategies slowly and not ruling out future changes, the suggestion that the dollar selling was mainly driven by hedging is slightly less serious for the dollar. The price for European investors to hedge US assets using the three-month forward is still relatively expensive at 2.4% per annum and suggests that foreign investors into the US will need a drip-feed of negative US news to keep dollar hedge ratios high/higher, even though it's becoming commercially more expensive. Last night's news on tariffs marginally narrows that risk premium and is helping the dollar.

For today, the focus will be on revisions to the first-quarter GDP data and initial claims. Presumably, we will all be watching President Trump's social media feed too to see what he makes of last night's court ruling on tariffs. We think the combination of this tariff news and a slightly hawkish FOMC minutes (almost all participants commented on the risk that inflation could prove to be more persistent than expected), can help the dollar stay bid in the near term. The best case for DXY is probably a 1.6% rally to 102.00 – but this won't be in a straight line and conditions will remain choppy.

Chris Turner

EUR: A leg to the downside

EUR/USD is understandably lower on the US tariff news in that it slightly re-appraises US growth prospects and the risk premium attached to the dollar. Is the rules-based order winning out after all? As above, a slight narrowing in the US risk premium on this news could see EUR/USD start to reconnect a little with the interest rate differential story. Here, the two-year EUR:USD swap differential is quite wide at 180bp – levels which last year prompted EUR/USD to trade down at 1.06.

We think global asset managers did have a shock in April and are seriously looking at their dollar hedge ratios. But the newsflow is mildly supportive for the dollar and there is a scenario where EUR/USD can make it back to the 1.1050 area – consistent with our baseline views for this year that EUR/USD traces out a 1.10-1.15 range.

The eurozone calendar is very light today, but we do have a new date for the diary: 25 June, when Germany could unveil a new economic package and add some weight to the fiscally expansive bullish euro story.

Chris Turner

GBP: Sterling performs well

It's interesting to see EUR/GBP still trading quite softly despite some better news on global trade. By nature of the UK's better trade position with the US and the fact that the UK has a trade deal, EUR/GBP normally should trade better bid on positive trade news. No doubt sterling's relatively high interest rates (4.30% per annum on a one-week deposit, versus 2.2% for the euro) are helping here. And there seems to be less fear over a tough UK government spending review on 11 June.

EUR/GBP looks comfortable down here in the 0.8350-0.8400 area.

Chris Turner

CHF: Swiss franc stays surprisingly bid

One might have expected EUR/CHF to trade a little higher on this tariff ruling and the decent rally in equity markets. The fact that it is still trading below 0.94 probably owes to creeping distrust of US Treasuries and the view that the Swiss National Bank is in a bit of a bind when it comes to interest rates and FX intervention.

Looking at the SNB, it is reluctant to take the policy rate negative again, but it looks like it will have to when it next meets on 19 June. Currently, the market is split between a 25bp and 50bp rate cut. Equally, investors are of the view that the SNB will be more constrained with FX buying intervention – an activity very much at odds with the directives coming from Washington. The big doubt now is that the SNB can be dovish enough in June to take pressure off the EUR/CHF downside, especially if the ECB is to cut twice more.

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