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FX

FX Daily: Dollar shrugs off oil sell-off

The dollar is rallying again, displaying strong fundamental backing (data, Fed) despite sharply lower oil prices. Tomorrow's FOMC is looking more and more like a key crossroads for FX. Elsewhere, the Bank of Japan hiked rates, but will probably still struggle to keep JPY afloat. In Australia, the RBA's hawkish hold didn't convince markets



We have published our monthly update of FX views and forecasts: [FX Talking: Dollar downturn delayed](#)

↑ USD: Fed story dominates over oil

The first 36 hours of trading after the US-Iran deal point to a structurally stronger dollar than a few weeks ago. Nearly all weekend losses have already been reversed despite a sharp drop in oil, signalling that FX markets are shifting focus away from crude and back to central banks. Tightening expectations are increasingly driven by data and central bank communication rather than energy prices, unlike at the start of the Middle East war.

This puts [tomorrow's FOMC](#) firmly in focus for FX. The dollar can stay resilient, but needs a nod from policymakers (especially from new Chair Kevin Warsh) that rate hikes are a real possibility. Australia is an example of the higher bar for hawkish communication set by markets: the RBA governor tried to deliver a hawkish hold this morning, explicitly saying

inflation is still too high and rate hikes remain a possibility. But markets seem more focused on the softer growth story and short-term swap rates have come under pressure along with AUD.

Today, market sentiment will probably be swayed by any new details about the US-Iran Memorandum of Understanding, still unpublished ahead of Friday's signing in Switzerland. President Trump has sounded very optimistic that the Strait of Hormuz will reopen by Friday, but European leaders at the G20 meeting have flagged concerns about the timing, in particular due to de-mining operations. This keeps questions around the durability of the oil sell-off open, and FX markets are, for now, reluctant to fully price in that optimism.

Francesco Pesole

↓ **EUR: Very unstable floor**

EUR/USD is back to Friday's levels. As discussed above, we see this as another clear signal that markets are focused on the central bank story much more than oil prices.

The two-year EUR:USD swap rate differential has retained a widening bias since the weekend, and keeps hovering around the pre-war 110-115bp area. The crucial difference back then was, however, that Europe had a relatively attractive growth story, and the Fed an easing bias. Fed moves tend to have greater implications for EUR/USD than the ECB's due to the knock-on effect on global sentiment, and when adding the severely damaged eurozone growth, it's understandable markets aren't jumping on bullish bets on the pair just yet.

We still think some downside risks remain for EUR/USD, which could explore sub-1.150 levels on any fresh concern about the sustainability of this deal, delays in Hormuz reopening, or further data divergence between the US and eurozone.

Francesco Pesole

↓ **JPY: BoJ hike no game-changer for yen**

As expected, the BoJ today hiked the policy rate by 25bp to 1.00%. Interestingly, it sounded quite positive on underlying economic momentum and warned that tight labour markets could trigger second-round effects. However, it still pitched its monetary policy settings as accommodative to support growth, and it is a reminder that, unlike other central banks, e.g. the Reserve Bank of Australia, it is not applying the brakes to slow the economy.

The market thinks the next follow-up hike will not emerge until December. This leaves Japan with comfortably negative real interest rates and leaves the yen as a funding currency if volatility slows even more this summer and renewed interest emerges in the carry trade. Tomorrow's FOMC meeting will also have a strong say in where USD/JPY goes from here. So far, FX intervention has been ineffective and until it becomes clear that the dollar is ready to turn lower, USD/JPY looks skewed to a retest of this year's 160.70 high, with risks to the 161/162

area, where more BoJ intervention should be expected.

The BoJ presumably acknowledges that FX intervention is more of a containment exercise this summer.

Chris Turner

➔ **CEE: Tighter differentials don't allow the FX to rally too much**

The US-Iran peace deal brought expected relief across the market yesterday, including the CEE region, particularly visible in the rates space. All three major markets in the region saw a rally in the IRS curve of around 10-20bp and a significant reduction in rate hike pricing. On a one-year horizon, the market has stabilised pricing around two rate hikes in the Czech Republic, including this week's meeting, half a rate hike in Poland and four and a half rate cuts in Hungary. This seems to be the minimum the market is able to expect in the Czech Republic and Poland, and we expect rates to stabilise somewhat there. In Hungary, we believe the market is able to price in more, especially with the likely NBH rate cut next week.

The market should remain in a somewhat positive mood for the next few days, but so far we haven't seen much in the FX market except the Hungarian forint, which continues to enjoy a post-election rally with EUR/HUF touching 350 yesterday, our mid-year target set shortly after the April elections. The zloty and koruna, however, did not benefit much from the risk-on sentiment yesterday. EUR/USD also did not see much movement, and it seems that rates and the rate differential are gaining more weight and influence on FX, and we see some reconnection. However, the rapid rally in rates also means a narrowing of the rate differential and a deterioration in the attractiveness of these currencies.

EUR/PLN, in our view, is heading back towards the upper edge of the current 4.225-265 range. EUR/CZK may be more driven by the CNB rate hike and forward guidance after the meeting. However, the hawkish bias should keep the CZK supported and heading below 24.100.

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