

FX Daily: Dollar strength is here to stay

With risk assets continuing to show instability and markets having now made a conviction call on the Fed's aggressive tightening cycle, the dollar has likely found a new floor. High-beta currencies are more likely to remain vulnerable, in our view, but EUR/USD could still approach 1.05. Elsewhere, the yen faces downside risks as the BoJ announces policy



New US dollar loans are choosing between term SOFR and SOFR in arrears

➔ USD: Turbulent markets mean supported dollar

The respite to risk assets offered by China's policymakers yesterday proved short-lived, and equities went through another rough session as the theme of global monetary tightening and slowing growth continued to resonate loudly across markets.

In such an environment, trying to pick the tops in the dollar rally is a risky challenge. The Fed's tightening cycle is largely priced in, but we surely do not see the divergence between market expectations and central bank communication that we witness in the case of other major central banks. With the Federal Reserve having largely endorsed the market's hawkish pricing, any risk related to a material dovish re-pricing seems quite remote for the dollar.

In our view, the balance of risks for the greenback remains skewed to the upside in this unstable risk environment. Further dollar gains look more likely against high-beta currencies, but DXY (where low yielders weigh more) may still break above two-year highs and consolidate above 103. Data-wise, some focus will be on wholesale inventories and housing data today in the US.

The risk-off mood has, for a change, offered some support to the yen, which also appeared to get some extra buying interest ahead of tomorrow's Bank of Japan policy announcement, where JPY volatility will be a central theme. A key question is whether it's going to be – if anything – the volatility itself (i.e. the rate of change) or a specific level of USD/JPY that would trigger firmer action by Japanese authorities to support the yen. We think the former is more likely to be the case, and we continue to highlight how FX intervention would not be straightforward and would require coordination with other G10 countries, especially with the Fed/Treasury. The lack of strong language to address JPY weakness by the BoJ tomorrow – given that no change in the ultra-dovish monetary stance looks likely – could trigger another USD/JPY mini-rally towards the pivotal 130 mark, although the global risk environment may put a cap on the pair for now.

➔ EUR: 1.05 is at reach

EUR/USD traded around the 1.0636 support (2020 lows) overnight, and a decisive break below such a level would place the next key support at 1.0500. The euro's blatant inability to rally on hawkish comments by European Central Bank members (not surprising though given 75bp of tightening by year-end is already in the price) means lingering vulnerability to an external environment negatively affected by an ever-concerning situation in Ukraine and generalised USD strength.

The euro could find some support tomorrow as inflation numbers from eurozone countries start to come in, but the chances of 1.0500 being tested by the end of the week have increased. Today, there are no data releases to watch for the euro, while the ECB's Philip Lane and Madis Muller will deliver speeches this morning. President Christine Lagarde will also participate in an interview later today, although monetary policy should not be the central theme.

➔ GBP: Too early to write off sterling

The pound has remained on a slippery slope, as the FX market continues to unwind long GBP positions related to the economic resilience of the UK and aggressive tightening by the Bank of England. Still, money markets continue to show six hikes fully priced in by the end of the year.

We think markets may be positioning a bit too much on the bearish side of sterling ahead of next week's BoE meeting, and the drop is starting to look stretched, especially in the crosses. We think a return to the 0.8300-0.8400 range in EUR/GBP may be on the cards over the coming weeks unless the BoE sends strong bearish signals.

GBP/USD, however, could remain vulnerable as the dollar retains some momentum. The 1.2500 support could prove a rather strong one, but further deterioration of the external environment could see that level being heavily tested before the end of the week.

➔ HUF: Forint remains in the grip of rule-of-law conflict

[Yesterday's National Bank of Hungary meeting](#) did not bring many surprises. As expected, the central bank raised the base rate by 100bp and confirmed that it will also raise the deposit rate on Thursday, by 30bp in our view. Forward guidance didn't change much either. However, the central bank seems more flexible and its next steps should be based on the next inflation developments and less just a copy of previous meetings.

From a market perspective, the meeting was a bit of a disappointment, although we don't see it that way. However, the forint seems to be more in the hands of risk aversion than rates and

continues on its upward path. A weaker forint may mean a more aggressive central bank, but for now, it is not a deal-breaker for the market and it is waiting for news from the government's conflict with the EU to reveal more and set the path for the currency. We see EUR/HUF around 370 in the short run with a possible quick move to 355-360 should we see a sudden de-escalation in geopolitics.

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