

## FX Daily: Dollar trapped between inverted curves and rallying equities

There has been little follow-through from the dollar selling we saw late last week. Currently, global markets present a curious picture of steeply inverting yield curves – which occasionally forewarn recession – but bid equity markets. Which market has it right? We tend to think the dollar will come lower in the second half, but again timing is everything



UK mortgage holders needing to refinance face yet more misery as two-year Gilt yields blasted through 5% yesterday

### ➔ USD: Dollar trapped in the middle of inverted curves and risk rally

FX markets are relatively quiet following yesterday's public holiday in the US. Risk assets are marginally softer after Chinese authorities only cut the 5-year Loan Prime Rate by 10bps – disappointing those looking for more aggressive support from lower mortgage rates to China's property sector. USD/CNH pushing back up to 7.18 has kept USD/Asia bid and provides a mildly bullish undercurrent to the dollar as the European session gets underway.

Softening the lens a little we see the dollar trapped between two stories and reflected in its 2% gains against the yen and 2% losses against sterling and commodity currencies over the last

month. Those two stories are: i) steeply inverting yield curves as central banks try to squeeze inflation out of economies and ii) rallying equities on the view that recessions will be mild (perhaps because of low unemployment). Our big picture call here is that US disinflation comes through in the third quarter, bearish US yield curve inversion switches to bullish steepening, and the dollar falls more broadly. But we are not there yet.

Back to the short term, there is only second-tier US data today in the form of housing starts and we have the Fed's James Bullard speaking at 1230CET today. He is one of the most hawkish Fed governors, but not an FOMC voter this year. Presumably, he may shed some light on why the Fed could hike by another 50bp this year (consistent with the latest Dot Plots), but that may not move the dollar needle much.

DXY is to trade well within a 102.00-103.00 range and expect USD/JPY to continue nudging higher. It increasingly looks as though Japanese authorities will be called into FX intervention again near the 145 level.

*Chris Turner*

## ➔ EUR: Little follow-through buying as yet

EUR/USD is becalmed above 1.09 and waiting for the next significant input. Given a light US and eurozone calendar this week, that may mean that EUR/USD gets dragged around by GBP/USD on the release of UK CPI data tomorrow and the Bank of England (BoE) meeting on Thursday.

EUR/USD has just about held above the 1.0910/30 support levels we highlighted yesterday but really needs to push ahead today to confirm bullish momentum. Otherwise the slightly bearish risk environment and strong dollar narrative can suck EUR/USD back down to the 1.0800/0850 area later this week. However, there seem few catalysts for a stronger euro today and ECB speakers seem unlikely to alter expectations that the ECB may hike twice more by the end of this year.

Elsewhere, we note EUR/SEK is trading to new highs. Investors remain very focused on the Swedish real estate story. Let's see whether Riksbank Governor Erik Thedeen has more to say on this topic when he speaks at 1540CET today. Earlier this month the Riksbank called on Swedish property companies to strengthen their balance sheets.

*Chris Turner*

## ➔ GBP: Cracks starting to show?

UK headlines were grabbed yesterday by two-year Gilt yields blasting through 5% and raining more misery on those UK mortgage holders needing to refinance. The UK 2-10 year Gilt curve is now the most inverted since 2000. It's true that a heavily inverted Gilt curve makes it more expensive for foreigners to hedge UK Gilt holdings – i.e. a sterling positive – but this heavily inverted curve will be heaping a lot of pressure on the UK economy. We are probably reading too much into one day's price action, but it could be noticeable that sterling did not follow Gilt yields higher yesterday.

Expect EUR/GBP to consolidate into tomorrow's big release of May UK CPI. And again we would see current levels in EUR/GBP as a good area to increase FX hedge ratios on GBP receivables.

*Chris Turner*

## 📈 HUF: Weaker levels are an opportunity for the market

Today, the only major event in the CEE region is the meeting of the Hungarian National Bank. Indicators of external balances are improving, while disinflation accelerated in May. This looks like a perfect setup for a “copy-paste” decision. [We see 100bp of cuts](#) to the top-end of the interest rate corridor and to the overnight quick deposit rate. The forward guidance and the tone will remain unchanged as well, in our view. This means that the approach remains cautious and gradual and the decisions ahead are still data and sentiment driven with the base case.

The Hungarian forint has been trading above 373 EUR/HUF for the last few days, the weakest since April. However, the main driver seems to be the current jump in gas prices. However, these have been falling again in recent days. Moreover, we think the market likes the normalisation story of monetary policy in Hungary, which will again attract the market to buy the forint. By far the highest FX carry in the region is still a key benefit here and we expect weaker forint values to offer an opportunity for the market to build long positions again. Overall, we thus expect the forint to return to 370 EUR/HUF, which is near the lower end of the 368-378 EUR/HUF range we expect for the rest of this year.

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