

FX Daily: Don't rule out a 75bp hike by the Bank of Canada today

While our base case is that the Bank of Canada will hike by another 50bp today, the strong macro picture means that a 75bp move cannot be excluded. Elsewhere, data resilience and higher yields should lay the basis for a re-strengthening of the dollar, and the contrast with a worsening growth picture in Europe may send EUR/USD back to 1.05 in June



Source: Shutterstock

Thursday 2 June and Friday 3 June are national holidays in the UK. We will resume the publication of the FX Daily on Monday 6 June.



USD: Finding fresh support

The dollar has continued to find some support this morning, benefiting from a general sell-off in the bond market, the impact of the EU oil embargo on Russia, and better-than-expected US data (consumer confidence yesterday was a case in point). The past few days seem to have conveyed the message that the Fed's tightening cycle is based on a sturdier growth story than Europe's (especially after the Russian oil embargo) and the speculation around a September Fed pause is being kept at bay for now. Ultimately, we think all this is laying the basis for a period of gradual re-strengthening in the dollar.

Today, data will remain in focus in the US, as the ISM manufacturing and JOLTS job openings for May are released. On the Fed side, John Williams and the arch-hawk James Bullard are both scheduled to speak today, and markets will also keep an eye on regional trends emerging from the Fed's Beige Book released this evening.

All in all, we expect the dollar to find some consolidation and possibly inch higher against most G10 peers for the rest of the week, with the weak bond environment offering a short-term supporting driver (the yen is set to remain the main victim here) and US data - our economist expects another solid US payrolls reading on Friday - still supporting the Fed tightening story and offering a longer-term bullish USD argument.

Some stabilisation in global sentiment may allow high-beta currencies - and especially oil-sensitive ones like Canada's dollar and Norway's krone - to find a floor, while other European currencies may remain on the back foot due to a worsening growth outlook in the region. DXY may advance to the 103.00 area in the run-up to the 15 June FOMC meeting.

↓ EUR: On track for a return to 1.05

EUR/USD is re-testing the 1.0700 support this morning after a marginal recovery late yesterday proved very temporary. Indeed, the common currency is discounting the re-assessment of the European economic outlook after the EU announced a ban on Russian oil.

That news came in conjunction with evidence that inflationary pressures in the eurozone are still not easing, as eurozone-wide CPI figures for May jumped to 8.1% while the core rate advanced to 3.8% year-on-year. While high inflation is keeping the ECB tightening expectations supported, the euro - which is already embedding a good deal of monetary tightening - is struggling to find any solid bullish driver at the moment. In our view, this was a matter of time and we continue to target a return to the 1.0500 area in EUR/USD by the end of this month.

Elsewhere in Europe, the Hungarian central bank raised its base rate by 50bp yesterday in line with market expectations, but didn't meet all expectations, [including ours](#). Even the almost historically weak forint did not persuade the central bank to make a bolder move. We did get assurances that monetary policy tightening will continue, but at a slower pace regardless of market or economic conditions. Although the central bank tried to be as hawkish as possible in its communication, it was not enough for the market to reverse the forint's direction.

The forint continues to be our least preferred currency at the moment, but on the other hand, still has the most potential to strengthen in the region. We see EUR/HUF around 390 in the short run with a possible quick move to 380 should one of the external factors (war, rule-of-law debate, etc.) show early signs of improvement, reducing the risk premium.

📌 GBP: Some weakness (but not a collapse) ahead

The pound seems to have been caught in the crossfire of the EU-Russia oil embargo story, largely following other European currencies (except for NOK) lower. This has meant that EUR/GBP has remained tied to the 0.8500 level, which appears to be an anchor for the short term.

Given a deteriorating growth outlook in the UK, we expect some GBP weakness ahead and see a move to 0.8600 in the coming weeks as likely. However, we do not see a sterling downtrend morphing into a collapse.

With UK markets closed for two days, expect reduced GBP volatility into the weekend.

📌 CAD: We expect 50bp by the BoC today, but 75bp is possible

The Bank of Canada is set to raise interest rates for a third consecutive meeting today, and the Bank's recent communication has strongly suggested we'll see another 50bp hike. As discussed in our [BoC preview](#), 50bp is also our base case scenario for today, given the strong economy (and an outlook helped by high commodity prices) and jobs market, as well as elevated inflation.

Against such a macroeconomic backdrop, we don't exclude a 75bp move: markets seem to attach a relatively high probability to this scenario given that 70bp are priced in ahead of today's meeting.

As we see a 50bp hike as more likely, there are some downside risks for CAD today, as markets may have to price some 10-20bp out of the CAD swap curve. That said, we think that the BoC will reiterate a very strong commitment to fighting inflation and allow markets to consolidate their bets on at least another 50bp hike in July and a terminal rate around 3.0%. Ultimately, this should put a floor under the loonie, which has been displaying some resilience against the USD rebound, and may not depreciate beyond the 1.2700-1.2750 area even if the 75bp bets have to be scaled back today.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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