

FX Daily: Expeditious Fed to keep dollar supported

Minutes of the March Fed meeting show that were it not for the war in Ukraine, the Fed would have kicked off its tightening cycle with a 50bp hike. The fact that the Fed wants to move to a neutral posture 'expeditiously' and that even tighter policy (restrictive, not neutral) may be warranted, should keep the \$ bid. Look out for Fed speakers and ECB minutes today



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USD: FOMC minutes were hawkish

The takeaway from the March Federal Open Market Committee (FOMC) minutes last night was that the Federal Reserve seemed confident enough about growth and the labour market, but that inflation needed to be addressed – and fast. It seems clear that the Fed would have opted to start the cycle with a 50bp hike were it not for the war in Ukraine. Some clarity was also provided on quantitative tightening – i.e. the speed at which the Fed will shrink its balance sheet. Based on the minutes and recent comments from Fed dove Lael Brainard it looks like the Fed will start shrinking its balance sheet after the May meeting, at a rate of \$95bn per month. That's nearly twice as quick as was seen during the last balance sheet run down during the 2017-19 cycle.

All of the above points to the Fed applying a heavy foot to the brakes, which should be positive for the dollar. As we discuss in this month's FX Talking: [Go Hard or Go Home](#), few central banks will be able to match the pace of Fed tightening this year and the dollar should stay strong – especially against the low yielders of the Japanese yen and the euro.

For today, we have a few Fed speakers including the very hawkish James Bullard (15:00 CET). His views are well known and a lot of Fed tightening is already priced in. Yet we feel the dollar can play catch-up with some of the recent rise in short-dated US yields and see the US dollar index launching a test of 100 shortly.

➔ EUR: Look out for ECB minutes today

EUR/USD is consolidating under 1.10 as the market waits for the EU's next move on sanctions. Comments from President Mario Draghi overnight suggest a full EU embargo of Russian gas is still some way off. No doubt this will frustrate the US Administration, struggling to explain to Congress why the Russian rouble has recovered to pre-invasion levels. It seems only a full sanction of Russian energy (Russian gas sales generate about \$10bn in FX per month) will be enough to see the rouble coming under severe pressure again – even if Russia does end up defaulting on its sovereign Eurobonds – as recent US Treasury measures seem to intend.

For today, we will get to see the release of the European Central Bank (ECB) minutes for March. ECB minutes are typically less exciting than the Fed's. Money markets currently price 55bp of ECB tightening by year-end and we doubt ECB minutes will have much of an impact here. Look out, though, for any mention of the euro. The ECB has recently been expressing a little concern with EUR/USD under 1.10 and what it means for imported energy prices. Yet unless the ECB is prepared to hike more aggressively, any EUR/USD rally on ECB FX-linked comments looks unlikely to last.

EUR/USD may have a quiet day near 1.0900/1.0950, though our multi-day bias is lower and our multi-month bias for a 1.05-1.10 trading range.

➔ GBP: Chief economist Pill speaks at 14:15 CET

Recent euro weakness has seen EUR/GBP drift lower again. We have a target over the coming months near 0.82 – though that may be the extent of the GBP rally this year. As we discuss in FX Talking, the challenge for GBP will be if and when year-end market expectations for the Bank of England's (BoE's) bank rate adjust closer to 1.00/1.25% (our house call) versus the 2%+ currently priced. That adjustment is probably a 2H22 story for sterling.

For today, look out for a speech from BoE chief economist Huw Pill. Given high inflation that will go higher he may not want to issue a rate protest today (i.e. may not want to manage market expectations of the tightening cycle lower). Thus EUR/GBP can probably continue to bounce around the 0.83-0.84 range.

⬆️ PLN: National Bank of Poland goes hard

The theme of this month's [FX Talking](#) was that unless central bankers 'go hard' with monetary tightening, their currencies will suffer. Yesterday the National Bank of Poland (NBP) [went hard with a 100bp increase](#) compared to the 50bp consensus. Aggressive tightening from the NBP and yield curve flattening should be good for the Polish zloty. Our team in Warsaw expect the policy rate (now 4.5%) to hit 6.5% this year and 7.5% next year. The market seems to price 6.50% this year

but the 21 by 24 month Forward Rate Agreement (i.e. expectations for 3-month Polish rates in 21 months' time) prices rates at 5.65% – completely at odds with our call of 7.5%.

Our team, therefore, believes EUR/PLN will push to 4.58/59 in the coming days and 4.50 later in the year. Also helping the zloty should be strong support for it from the NBP and the decision to convert external transfers – e.g. EU payments and additional external aid – via the spot market into zloty. Also, look out today for the press conference from NBP Governor Adam Glapinski at 15:00 CET. Hawkish risks should keep the zloty supported.

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