

FX Daily: Fed exports higher rates through a stronger dollar

The dollar is currently up 11% year-to-date on some trade-weighted measures. Dollar strength is delivering some unwelcome loosening of monetary conditions in the rest of the world (RoW) as their currencies fall. In response, RoW central bankers are having to hike more aggressively. Expect large hikes in Poland and Hungary today and a more hawkish ECB



USD: June FOMC minutes as hawkish as expected

The dollar remains close to recent highs as recessionary fears mount, while central banks remain very much in hawkish mode. On that latter point, last night's release of the June Federal Open Market Committee (FOMC) minutes showed a Fed very much concerned by upside risks to inflation and prepared to take rates into restrictive territory (above 2.5%). Concerns about downside risks to growth featured very little and the Fed's risk management approach is clearly in favour of front-loaded tightening on the risk that inflation is more persistent than expected.

On that subject, EUR/USD one-week traded volatility is climbing back to recent highs near 12%. That is not a surprise given the event risks of the June US jobs numbers tomorrow, but particularly

the US June CPI release next Wednesday, where any upside surprises could again cause havoc in global financial markets.

Noticeable this week has been the EMFX complex coming under a lot more pressure – e.g. USD/BRL to 5.43, USD/ZAR to 16.75, etc. This has come in conjunction with the collapse in commodities and the re-assessment of global growth. Expect this theme to stay with us this summer, especially if inflation proves persistent and central banks have to push further ahead with their tightening cycles.

The strong dollar is also forcing trading partners to have to hike more aggressively too, as well as intervene in FX markets to protect their currencies. Given a difficult summer for risk, expect continued outperformance of the dollar, yen, and Swiss franc, while high beta (especially in Europe) and commodity FX will remain vulnerable.

Today's US data calendar is light and we doubt any small pick-up in initial jobless claims will be able to move markets much ahead of the NonFarm Payroll data tomorrow.

DXY should consolidate above 106.00.

➔ EUR: Parity within striking distance

One striking feature of the re-pricing of global growth over recent weeks has been that the ECB tightening cycle has been re-priced lower more aggressively than that of the Fed. Here two-year EUR:USD swap spreads have widened out again by a large 20bp this week, supporting lower valuations of EUR/USD.

As we discuss in our latest article, ["What happens when EUR/USD breaks parity?"](#) lower EUR:USD swap spreads are a key short-term driver of the EUR/USD, as is the global equity environment. We would continue to back Fed tightening holding up better in this summer's equity bear market and there are no signs yet of a significant floor in EUR/USD. Expect shallow consolidation now – likely to be capped by a maximum 1.0350/70, or more likely 1.0270 – before the assault comes on parity. Tomorrow's NFP or next week's US CPI look the best candidates to trigger the test of parity.

However, the ECB will be worried. The central bank's trade-weighted euro has fallen to a new low for the year and is now down 6% on a year-on-year basis. This will be adding to headline inflation. We can expect the ECB to threaten more aggressive rate hikes, e.g. 50bp at the July meeting, but given the global and European growth environment, hawkish rhetoric looks unlikely to deliver much of a euro bounce.

➔ GBP: Political mayhem leaves GBP very volatile

It seems unlikely that Prime Minister Boris Johnson will be able to hang onto the keys of Number 10 into next week. This will then prompt a Conservative leadership election and possibly some earlier fiscal stimulus than had been expected. That makes sterling a tricky sell. And probably one of the reasons that sterling has not sold off more is because of the large Tory majority in parliament.

As we said yesterday, GBP/USD remains vulnerable to the global recession/equity bear market story – bias to 1.17 maybe 1.15 here – while EUR/GBP looks more volatile in a 0.8550-0.8650 range, where the Bank of England looks more aggressive on tightening than the ECB.

CEE: Futile efforts by central banks to halt the region's FX decline

Wednesday proved another day with a stronger dollar and brought more bloodshed in the central and eastern European FX space. The forint briefly looked above 415 EUR/HUF and the zloty above 4.80 EUR/PLN yesterday. Today, central banks will step in with their attempt to stop further currency depreciation in the region. Although a 50bp hike in Hungary's one-week deposit rate was already on the cards for today, yesterday's National Bank of Hungary (NBH) announcement that today's decision would be "decisive" suggests more of a 100-150bp move, in our view. Even so, this would still be a market disappointment. The NBH has little chance of stopping the current move in the forint, which is the weakest in history.

In Poland, [we expect the National Bank of Poland \(NBP\) to hike its rate by 75bp](#) to 6.75%, but the situation is not much easier here. On the one hand, PMIs suggest a sharp slowdown in the economy, on the other hand, inflation has hit 15.6% YoY and the zloty is the weakest since the start of the Ukrainian conflict.

The Czech koruna stands on the sidelines in this turmoil, while the central bank is successfully keeping it near 24.75 EUR/CZK. However, the Czech National Bank (CNB) could also come into play today. Although the CNB's official calendar is rather unclear due to the Czech Republic holidays, normally the board meets every Thursday. This time, however, will be the first time under a new governor and a new board. Of course, one of the topics will be FX interventions. However, we do not expect any changes.

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