

FX Daily: Fed's hawkish hold can put a floor under the dollar

We expect the Fed to hold today but signal more tightening is possible. The endorsement of market pricing for future hikes can ultimately keep the dollar around strong levels for a bit longer. We expect EUR/USD to end the week closer to 1.0700 than 1.0800 when also factoring in the ECB meeting. In Sweden, an inflation surprise may bode well for a SEK recovery



Jerome Powell, Chair of the Federal Reserve

We have published the June edition of [FX Talking: "Burden of proof"](#), which includes our latest views and forecasts for all G10 and EM currencies

USD: We expect a hawkish hold by the Fed

Yesterday's CPI numbers in the US had the potential of being the biggest risk event for markets this week, but May's figures ultimately came in very close to consensus expectations: core inflation moved by 0.4% MoM (5.3% YoY, slightly above expectations), while the headline rate decelerated

to 4.0%, a touch more than expected. On balance, Fed fund future pricing tells us that markets saw the release as slightly dovish, and the implied probability of a rate hike today was trimmed to 12% from 23% pre-CPI.

The dollar is trading moderately weaker into the FOMC day, with the post-CPI reaction in the currency market seemingly following a risk-on, European-rotation rationale: the high-beta NOK and SEK shone, while the yen dropped yesterday. USD/JPY is dangerously close to the 140.90 30 May high, which would leave the yen vulnerable to a move to 145 area, where Japanese authorities started to intervene last September. The Bank of Japan announces policy on Friday, and the response that we are seeing in the FX market is probably a testament that market expectations for possible policy adjustments are rapidly disappearing at this Friday's meeting.

Our original call for today's Fed announcement was a hawkish hold, and yesterday's deceleration in inflation gave us no reasons to review it. Our economist discusses [here](#) why the latest CPI read could mean we are indeed at the peak of the Fed's rate cycle, while [here is our scenario analysis for today's FOMC policy announcement](#). Despite the welcome developments in inflation, the Fed wants to see a 0.2% MoM or below CPI readings to feel confident inflation will return to target, and this is why we think today's statement will include a quite explicit openness to further tightening in the future, which could be expressed via the wording "future increases may be appropriate".

While our base case is that Dot Plot projections will be kept unchanged, it is surely possible that the committee will add another hike to the 2023 median forecast. The Dot Plot can really swing the balance for the dollar reaction: we think signalling another hike in the 2023 projections would trigger a quite substantial dollar rally as markets see the July meeting as the most likely date for the next rate increase. We don't see negative implications for the dollar in our baseline scenario (hawkish messaging, unchanged median Dot Plot), as the endorsement of the market's hawkish repricing of Fed expectations should keep the recent bullish narrative for dollar alive for a bit longer: that is, until data takes a decisive turn for the worse in the US.

Francesco Pesole

📌 EUR: Another day driven by the US

As discussed in our June [ECB Cheat Sheet](#), we see developments in USD rates as more impactful in the longer run for EUR/USD compared to the what might emerge from tomorrow's ECB meeting.

In terms of short-term impact, we expect the combination of a hawkish hold by the Fed and a hawkish 25bp hike by the ECB to leave EUR/USD trading closer to 1.0700 than 1.0800 as we expect the FOMC to offer reasons to stay attached to dollar longs. The ECB may struggle more to convey a hawkish message, after inflation and growth data came in on the softer side.

Francesco Pesole

📌 GBP: Hard to buck the sterling bullish trend

EUR/GBP pressing lower again this morning: a move below the 0.8540 support would set the pair back to pre-Mini-Budget crisis levels (August 2022). UK GDP figures for April matched expectations, showing 0.2% MoM growth, while industrial production declined by more than expected (1.9% YoY).

Still, latest evidence from employment and wage growth have prompted yet another repricing

higher in BoE rate expectations, with 132bp of tightening priced in by year-end. With short-dated gilts reaching highest levels since 2008 yesterday, it remains hard to buck the EUR/GBP bearish trend, especially ahead of the ECB risk event, but our medium-term view remain bullish on the pair.

Francesco Pesole

📌 SEK: Higher core CPI good news for SEK

In the midst of a quasi-currency crisis in Sweden over recent weeks, we had indicated today's CPI release as a potentially pivotal moment for the krona. This proved to be the case. Both core and headline inflation for May came in hotter than expected: YoY readings were 9.7% for CPI (exp. 9.5%), 6.7% for CPIF (in line with consensus), and 8.2% for CPIF excluding energy (exp. 7.8%). This last core gauge is the one that the Riksbank is mainly focussing on: it declined faster than expected in April, from 8.9% to 8.4%, but it clearly decelerated its slowdown in May, to 8.2%.

The implications for monetary policy, and for the krona, are non-negligible. A key reason behind the recent SEK weakness was effectively the lack of support by the Riksbank after a dovish turn at the April policy meeting. Since then, except for verbally protesting a weak krona, the Bank had failed to offer a convincingly supporting narrative to the domestic currency (i.e. via rebuilding some hawkish narrative). These higher inflation numbers offer an opportunity for the [two dissenters](#) to scale back their dovish opposition at the 29 June meeting and to allow a rebuilding of that hawkish messaging (hike and signal more to come) that can help a more sustained recovery for SEK.

We cannot unsee the significant domestic downside risks for SEK (SBB, troubled economic and real estate outlooks), but the Riksbank has an opportunity to give a lifeline to the krona and wait for more market stabilisation to do the heavy lifting and bring EUR/SEK closer to 11.00 later in the year. We are slightly more constructive on the EUR/SEK near-term outlook after today, although we warn against excessive confidence in the Riksbank adopting what we see as the best policy for the currency. Risks of spikes to 11.60-11.70 remain elevated, but a hawkish Riksbank could now take the pair sustainably below 11.50 by the summer.

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