

## FX Daily: Hanging on to the dollar ahead of the Fed

The dollar has remained bid ahead of tomorrow's Fed meeting, and we think it is still risky to pick the top in the dollar rally given the prospect of aggressive tightening and the challenging global environment for risk. EUR/USD is at risk of a decisive break below 1.0500 this week. Elsewhere, the RBA's hawkish turn may not prove enough to materially lift AUD



The Fed raised rates by 75bp

### ➔ USD: Remaining supported into the FOMC

The dollar has continued to strengthen ahead of tomorrow's FOMC meeting, where a 50bp rate hike and the start of quantitative tightening are widely expected to be announced. We sum up our views ahead of [tomorrow's meeting](#) here. From an FX perspective, we would still refrain from making a confident call that a top in the dollar has been reached. Even if the Fed-induced strength might appear more limited now that an aggressive tightening cycle has been priced in, an external environment where markets find other key non-US markets unattractive (namely, China due to lockdowns, Europe due to geopolitical risk, other emerging markets due to tightening financial conditions) offers quite a solid floor to the dollar, in our view.

Yesterday's muted dollar reaction to some disappointing ISM manufacturing figures was a case in point: the underperformance of European equities compared to the US seemed to be a bigger driver of US-European FX dynamics. The service ISM will be released a few hours before the Fed announcement tomorrow, while the data calendar is quite empty today.

We continue to see high-beta/commodity currencies being at risk in the current choppy environment for risk sentiment, and the DXY (where low-yielders have a big weight) may not be a very indicative benchmark for dollar strength at the moment. Still, a move into the 104/105 range into the Fed meeting seems reasonable.

In a week where aggressive central bank responses to inflation are taking centre stage, the Reserve Bank of Australia sent a firmly hawkish signal this morning, as it hiked rates by 25bp (to 0.35%) and announced it would stop reinvesting maturing assets, therefore allowing its balance sheet to shrink over the coming quarters. Markets were expecting a 15bp raise, and the Aussie dollar jumped after the statement, which also included indications that more monetary tightening is on the way.

The AUD rally has proven, however, relatively short-lived, which is not entirely surprising given that: a) markets were already pricing in a cash rate of 2.60% by year-end (they now expect 2.80% after the hike); b) lingering concerns on China's Covid crisis are weighing on the Antipodeans. Also from a forward-looking perspective, these two factors (paired with USD resilience and unstable risk sentiment) suggest the upside for AUD/USD may still be limited to the 0.72/0.73 area in the coming weeks.

## 📉 EUR: A move below 1.0500 looks likely this week

EUR/USD is currently struggling to stay above the key 1.0500 support as an appreciating dollar, underperforming European equities and fears of a prolonged Russia-Ukraine conflict as well as ever-deteriorating diplomatic relations between Moscow and Brussels all continue to point to weakness in the pair.

It is now clear that the euro is embedding a good deal of negatives and that more bearish pressure would make the EUR/USD downside look quite overstretched. That said, we think markets could refrain from jumping back into bullish EUR bets before the European Central Bank sends a signal that monetary tightening is imminent. Hawkish comments by ECB speakers may continue to prove insufficient for a market that already prices in 85bp of tightening by year-end: a EUR recovery likely requires a shift in the ECB policy statement, and the timing on that remains uncertain (the next meeting is on 9 June).

Until that happens, EUR/USD remains at risk of dipping below 1.0500. A week with the FOMC meeting and not much action on the eurozone calendar/ECB speaker side could definitely see a decisive technical break lower materialise.

## ➡ GBP: BoE may defy hawkish expectations on Thursday

Expect a couple of days of "wait-and-see" in the GBP crosses as investors hold their breath ahead of the Bank of England meeting on Thursday. We outline four different scenarios for the BoE meeting and their implications for rates and FX [in this article](#). Our base-case scenario is a 25bp rate hike, supported by eight out of nine MPC members.

We think that would prompt a bit more dovish repricing across the GBP curve and the pound could moderately weaken after the rate announcement. Such weakness should prove more pronounced against the dollar, which could find some more support from the FOMC meeting, and EUR/GBP upside could still be capped to the 0.8450-0.8500 area for now.

## ➔ CEE: Despite great potential, the region will have to wait for new gains

This week we have monetary policy meetings in Poland and the Czech Republic. The National Bank of Poland is expected to raise rates by another 100bp to 5.50%, but another massive surprise in inflation last week may again lead the board to move more aggressively. In any case, rates should support the Polish zloty, which we believe has great potential for gains and, unlike the Hungarian forint, is not hampered by domestic political issues. However, we cannot expect an early change in the market's risk aversion and the zloty will have to wait a while to return to stronger levels.

The Czech National Bank is closest to the peak in the region in the hiking cycle. [We expect another 50bps hike this week](#) to 5.50% and although we see room for further rate hikes in June, the central bank's new forecast will have a rather dovish message due to the rate cut projection, which will complicate the koruna's return to stronger levels.

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