

FX Daily: How hawkish is too hawkish?

The RBNZ signalled a terminal rate around 4.0% in 2023, following a 50bp hike today. We suspect the rate projections may be too hawkish, but this is a story for the long run: for now, 50bp hikes should keep the NZD on track for a return to 0.70 by year-end. Elsewhere, USD may struggle to recover, but a move to 1.08-1.09 in EUR/USD is not our base case



The Reserve Bank of New Zealand hiked rates by another 50bp to 2.0% today. Pictured: RBNZ Governor Adrian Orr

📉 USD: Risk sentiment remains the primary driver, but downside risks are smaller now

The shockwaves that originated from the slump in US tech stocks yesterday seem to have been absorbed without too much trouble by global equity markets, although more signs of sentiment instability did take some steam off the rally in pro-cyclical currencies. The dollar has found some stabilisation after a negative start to the week and should, for now, continue to trade primarily in line with swings in global risk sentiment.

Yesterday, [new home sales in the US dropped](#) much more than consensus, a first sign of how higher interest rates are starting to impact the US economy. The data also increases the significance of today's mortgage application numbers, where another big drop (surely possible given the rising mortgage rates) would likely fuel concerns about an economic slowdown. After all,

construction makes up 4% of GDP and retail sales are correlated with housing activity.

It may be too soon for the dollar to start discounting a higher risk of US slowdown via the Fed rate expectations channel, but some grim mortgage application figures could contribute to the dollar's softish momentum if equities enjoy a session in the green as futures seem to suggest this morning. At the same time, we think that the downside potential for the dollar is shrinking, especially given a more balanced positioning after a widespread position squaring and a still supportive Fed story.

When it comes to the Fed, markets will surely take a close look at the minutes from the May FOMC meeting this evening to gauge how much consensus there was about multiple 50bp increases over the summer and whether there were some dissents about ruling out 75bp hikes. We'll also hear from Lael Brainard today.

➔ EUR: A move to 1.08-1.09 would be too stretched

EUR/USD broke the 1.0700 mark yesterday, as markets probably feared a wider drop in the eurozone PMIs, which instead came in only slightly below consensus. The combination of some easing in stagflation-related concerns, hawkish re-pricing of ECB rate expectations, and a weak dollar momentum have all contributed to the recent EUR/USD rally. Now, it appears most of the positives are in the price, especially considering that markets are already pricing in 100bp of ECB tightening by year-end, and we think a consolidation looks more likely than an extension of the rally to the 1.08-1.09 region.

The eurozone calendar doesn't include market-moving data releases today, but there is a long line of scheduled ECB speakers to keep an eye on: Christine Lagarde and Klaas Knot in Davos, Robert Holtzmann, Pablo Hernández de Cos and Philip Lane elsewhere.

⬆️ NZD: Has the RBNZ gone too far with rate projection?

The Reserve Bank of New Zealand hiked rates by another 50bp to 2.0% today – in line with market expectations – but delivered a substantial hawkish surprise with its updated rate projections, which signalled an even more aggressive front-loading of monetary tightening. The Bank now forecasts the policy rate at 3.25-3.50% by year-end (up from 2.25-2.50% in the February projections) and around 200bp of total tightening by the end of 2023 – therefore signalling a terminal rate around 4.0%.

We start to suspect that the RBNZ might have gone too far on the hawkish side with its rate projections and could struggle to deliver on them, especially if we see a considerable cooling-off in the New Zealand housing market and a generalised global slowdown. That, however, is a story for the long run. In the short term, we have a near-guarantee that the RBNZ will deliver two more half-point hikes this summer, which should keep rate expectations anchored to the new RBNZ projections and allow NZD to maintain a wide rate differential against all other G10 currencies.

Ultimately, this should fuel a return to 0.7000 in NZD/USD by 4Q22 or 1Q23 at the latest, in our view. However, the short-term outlook for NZD (and its ability to consolidate above 0.6500) remains strictly tied to swings in global risk sentiment and the Chinese economic outlook, which remains a major source of uncertainty.

📌 CZK: CNB intervenes rather verbally, but that may change soon

Daily banking sector liquidity data over the past two weeks, during which the CNB has officially been intervening in the FX market, do not suggest significant central bank activity. This is in line with [our expectation](#) that the CNB's initial intervention was mainly verbal as in March. This was confirmed in an interview last week by Vice Governor Tomáš Nidetzký, who indicated that the market does not want to fight the CNB. Nevertheless, the koruna continues to lose support from the interest rate differential, which has returned to the level of early May. Thus, in our view, the next CNB dovish move (for example the appointment of new board members, new governor forward guidance) will require a more aggressive approach by the central bank in the FX market if it is serious about intervening.

We continue to expect the central bank to keep the koruna below 25 EUR/CZK and, given the again surprisingly high CPI prints, may try to get the koruna closer to 24. However, we still don't have much indication of what will happen with interventions after 1 June, when the new board's term begins. Aside from the name of the new governor, we have no indication yet as to who else will be appointed to the board. In our view, this will be a topic for next month and we expect to know the composition of the new board before the CNB meeting in June.

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