

## FX Daily: It's good to be hawkish

Uncertainty in the Gulf and high oil prices mean that central bankers remain on high alert for the broadening threat of inflation. The Reserve Bank of Australia hiked 25bp again overnight having seen second-round inflation effects emerge. How central bankers react to the inflation shock will be key for FX. And the dollar is getting a lift from the Fed story



Michele Bullock, Governor of the Reserve Bank of Australia, which raised rates by 25bp overnight after seeing second-round inflation effects emerge

### USD: Fed to examine the inflation vs. employment trade-off

A look at how G10 currencies have performed since the Gulf crisis started in early March shows the Australian dollar and Norwegian krone at the top of the pack and the Japanese yen and the Swedish krona at the bottom. The outperformers are net energy exporters, but also have policy rates at 4.00% and above backed by hawkish central banks. The underperformers have seen their terms of trade decline as energy import costs rise, plus have pretty dovish central banks. It looks like investors are preferring currencies backed by central banks prepared to run restrictive monetary policy. In fact, the Reserve Bank of Australia overnight cited the emergence of second-round effects as one of the reasons driving its third hike in this tightening cycle – taking the policy to 4.35%. We also think there is a good chance that Norges Bank hikes this Thursday, which would take the policy rate to 4.25%.

We mention the above for some context on the dollar. Following last week's [hawkish FOMC meeting](#) and still elevated energy prices, the market has swung to pricing 6-7bp of Fed tightening this year. So, no longer is it just a question of delayed Fed easing, but whether the Fed will respond to this inflation shock after all with tighter policy. The debate here is where the Fed stands on its dual mandate of maximum employment and price stability, which brings us to the data this week. Here, the focus is very much on the jobs data, with JOLTS data (today), monthly ADP data tomorrow and the April NFP data on Friday. We suspect even a largish decline in NFP this month might not be enough to derail Fed tightening expectations, given the volatility of this jobs data recently and the emerging view that the size of the labour force may be flat right now.

In terms of the prices, the focus today will be on the ISM April services data and whether selling price expectations are picking up. If so – and also given that market-based measures of inflation expectations are on the rise – the Fed is going to be dragged more towards the price stability side of its mandate.

Unless there are clear signs of moves towards sustainable peace in the Gulf – and there is some focus that President Trump wants a deal before his trip to China on 14/15 May – we suspect high oil prices can keep short-dated US rates and the dollar bid. That can see DXY drifting back towards the 99.00/99.50 area this week.

*Chris Turner*

## 📌 EUR: Could natural gas be the next point of concern?

Somewhat ominously, ING's Head of Commodities Strategy, Warren Patterson, is today warning that the natural gas market is [underpricing the risks of lost supply](#) in the Persian Gulf. One of the saving graces for the eurozone this year has been that natural gas prices have spiked nowhere near as high as they did in 2022, meaning that the negative shock to the eurozone's terms of trade has been nowhere near as large. Should Warren be correct in that natural gas prices risk a sizeable leg higher, the euro would come under broader pressure.

In recent weeks, we have been pitching the story that 1.17 looks a fair level for EUR/USD given our key assumptions for energy prices, central bank policies and equity markets. That is still the case. But any further pricing of Fed tightening or much higher natural gas prices presents increasing downside risks to that 1.17 EUR/USD equilibrium.

Expect oil prices to again drive EUR/USD today, with risks slightly skewed more to the 1.1630/50 area.

*Chris Turner*

## 📌 JPY: Decreasing marginal impact of intervention

USD/JPY is drifting higher again as it recovers from the effects of Japanese FX intervention. It looks reasonably clear that the Bank of Japan sold in excess of \$30bn last Thursday and may have followed it up with more modest intervention over the last two trading days. Indications of whether there has indeed been follow-up intervention will not emerge until late Japanese time on Thursday when the BoJ updates its current account balance data. Nonetheless, the market is bracing for more intervention in holiday-thinned markets.

However, Japanese authorities will have their work cut out in trying to keep USD/JPY offered.

Energy prices remain high and US interest rates are on the rise, which creates stiff headwinds for any yen appreciation. And as we discuss above, dovish central banks are seeing their currencies being punished. In short, the fundamentals remain firmly yen negative and Japanese authorities are just trying to buy some time.

We suspect USD/JPY will drift back to the 160 level over the coming weeks unless there is a clear breakthrough in peace negotiations in the Gulf.

*Chris Turner*

## ➔ AUD: High-yielding commodity currency

AUD/USD is a little lower today despite the RBA hiking by 25bp to 4.35%. The sell-off looks to be driven by the view that the RBA may now be entering a pause, having brought policy to mildly restrictive. However, we doubt the sell-off needs to extend too far given that the RBA has once again followed through on its hawkish credentials and stands ready to do more. Here, the market thinks the RBA can skip the June meeting but hike again at either the August or September meeting.

Expect AUD to find continued good demand on dips and the core trend of bullish AUD/JPY to remain intact as investors position for the trade-offs in both energy dependency and central bank policy.

*Chris Turner*

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