

FX Daily: More grist to the stagflation mill

EU leaders last night took the decision to push ahead with an embargo on Russian oil - exempting pipeline oil imports to land-locked nations. The decision to deprive Russia of valuable export earnings comes at the cost of higher inflation and lower growth. How the ECB balances the trade-off between inflation and growth will be key for the euro and European FX



➔ USD: Dollar finds its footing

The dollar appears to have found some support on the last day of May. US yields have started to turn higher again, which looks both a belated reaction to Friday's strong US data, some very hawkish comments by the Fed's Christopher Waller, and Brent now breaking well above \$120/bl on the news that EU leaders will be pushing ahead with a Russian oil embargo after all.

The reason that the dollar is not firmer probably owes to the fact that bond yields are rising around the world - especially in Europe. Monday saw a very heavy sell-off in European bond markets after national CPIs surprised sharply on the upside. Indeed, today's release of eurozone May CPI should push up to 7.9% year-on-year - a new cycle high.

What does this all mean for FX markets? The Rest of the World (particularly Europe) playing catch-up with Fed policy has taken some steam out of the dollar's rally. But the reality is that the EU's

Russian oil embargo will weigh on European growth - most directly through the negative income shock of the terms of trade decline. This makes life very difficult for the ECB and leaves our ECB-watchers at ING expecting that the central bank will not fully deliver on some of the more hawkish outcomes currently being priced into eurozone money markets.

At the same time, one could argue that the Fed tightening cycle is built on more solid foundations and will occur at a time when 'household balance sheets are in great shape' - according to the Fed's Waller. We agree. In all, we expect the dollar later in the summer to push back to the highs seen in early May.

For today we should probably brace for a sharp drop in US conference board consumer confidence for May - which may stress-test the short-run stability of the dollar. DXY should find support around the 101.00/101.50 area.

➔ EUR: Learning to live with 8% inflation

Eurozone May CPI inflation should come in close to 8% YoY today. It will be interesting to see what this means for the ECB hikes. Have last week's blog post from President Christine Lagarde and comments from Chief Economist Philip Lane yesterday brought the entire governing board inside with 25bp hikes in July and September? Or will the hawks continue to push for 50bp in July? European bond markets certainly seem to fear the latter judging by yesterday's performance.

An ECB ready to act and prepared to take real yields higher continues to narrow the two-year Germany-US sovereign spread - now into 205bp from a wide of 255bp a couple of months ago. Undoubtedly, this has supported EUR/USD. We suspect that spread may struggle to narrow inside of 200bp and thus doubt that EUR/USD can sustain gains over the 1.08 area. We still have an end-June forecast of 1.05

Elsewhere look out for a [rate meeting in Hungary today](#). The National Bank of Hungary (NBH) has been managing expectations for a slower tightening cycle (i.e. 50bp instead of 100bp increments), yet pressure on the forint could prompt a slightly larger hike. ING's Peter Virovacz looks for a 60bp hike today. We fear today that the NBH's rate comments may not support market expectations of further hikes to the 8.25% area, leaving EUR/HUF to press 400. This may require follow-up action from the NBH on Thursday with a bigger hike in the one-week deposit rate.

➔ GBP: Sterling bears queuing up

There remains a lot of bearishness surrounding sterling. The argument goes that hiking rates in a softening economy is a sterling negative. And true, sterling has recently taken on the characteristics of a growth currency, being driven more by equities than rate differentials over recent months.

We are slightly negative on sterling - looking for EUR/GBP at 0.8600. But we think a lot of the weakness is a reflection of broad dollar strength and we are not looking for a sterling collapse. EUR/GBP will probably continue trading in a 0.8450-0.8550 range for the time being - i.e. an environment of greater volatility but within defined ranges.

⬆ CHF: SNB's Zurburegg speaks at 14CET

We do not hear too often from Swiss National Bank (SNB) speakers, but Vice Chairman

Fritz Zurburegg speaks [at an event at 14CET today](#). We are very interested in the SNB given that an ultra-dovish central bank has been sounding more hawkish recently. And it seems that tighter policy in Switzerland means a stronger nominal currency. Thus look out for today's event risk for the Swiss franc, and a pair like GBP/CHF - potentially breaking under 1.20 - could be the big story if this SNB speaker does take a hawkish turn.

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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