FX Daily: Dollar takes tapering talk in its stride

News from the FOMC minutes that a number of participants felt that tapering of asset purchases might be discussed at upcoming meetings could have given the dollar a big boost. The fact that it hasn't probably owes to the fact that progress towards the Fed goals is still ongoing and that the first Fed rate hike would still be a 2023 story.

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USD: Nonplussed by the crypto-crash

Reading through the FOMC minutes last night, the key sentence about a number of participants potentially being ready to talk tapering at upcoming meetings seemed a little incongruous with the rest of the document. The sentence may well have been a trial balloon to put tapering talk out there - but in a very gentle way. The fact that the Fed-sensitive five-year part of the Treasury curve only saw rates rise 4bp and that some of the high beta EMFX sold off less than 1% suggests investors are yet to jump into a narrative of early withdrawal of Fed stimulus.

Driving that is probably a sense that when the Fed does forewarn the market about tapering (June, July or September?) it will be wary of market surveys that it is expected to take three quarters to slow its asset purchases. And then a further three quarters before the first Fed rate hike. This all points to a first Fed rate hike in 1H2023. A Fed rate hike in early 2023 is currently priced by the market and how those expectations are brought forward - or are pushed back - will determine the path of the dollar and risk assets. On this subject we will hear from Fed non-voter Robert Kaplan today at 1630CET. He falls into the camp of those wanting an earlier discussion on tapering and his comments could provide a little support to the dollar.

Separately, FX markets were nonplussed by the 30% flash-crash and rebound in cryptocurrencies. One fear in FX markets is that increasing participation of institutional investors, in an environment of extended leverage, could trigger some broader-scale de-leveraging of positioning in FX markets. Notably, that did not occur yesterday and comments were re-assuring from Fed's Bostic, who said the Fed did not see cryptocurrencies as a systemic issue. Let's hope he's right.

For today, the FOMC minutes should provide the dollar with a slight bid and DXY could push up to the 90.60 area.

EUR: So far, so good

EUR/USD has held up pretty well amidst the first real wave of a Fed tapering discussion. Yet we have recently been highlighting how monetary policy normalization trends (particularly in Canada and Norway) have been driving FX trends - thus we should be wary about the dollar wanting to push a little stronger. The Fed has also been making worthy points about the volatility in data - and potentially in markets - over coming months on the back of the re-opening.

For today in Europe, we'll see Chief Economist, Philip Lane, discussing Europe and the global economy at 11CET. He's recently been sounding more upbeat, though is unlikely to provide many clues on the ECB's own tapering debate on June 10th. We are a little surprised that EUR/USD has not sold off more on the Fed tapering story and would see risk of a correction to the 1.2110/2120 area.

Elsewhere, we are pleased to see EUR/CHF crossing back above the 1.10 area. We see the potential to 1.15 later this year. And it is too early to expect a hike from Hungary at today's weekly deposit auction. Yet a 30bp hike in the benchmark rate should be coming in June and EUR/HUF should remain under pressure.

GBP: Steady as she goes

GBP has held up quite well this week. We had been a little worried yesterday that de-leveraging from the tech sell-off could spill over to position adjustment in FX. And here GBP could be vulnerable. Yet it seems the tech sell-off so far has yet to gain sufficient momentum to touch FX. We agree with investors taking a glass half-fill approach to the UK economy and prospects for GBP, which should keep GBP bid ahead of tomorrow's releases of April retail sales and May PMIs. We see Cable in a tight 1.4090/4100 to 1.4150/60 range today.

ZAR: SARB may not be rail-roaded into a hike

The SARB meets today to announce interest rates. No one expects a change in the 3.50% policy rate. Money markets price a 25bp hike over the next six months and a further 50bp over the subsequent six months. Most will expect the MPC to be hawkish, following in the steps of a central bank like a Banxico, who have over recent months unanimously voted that the easing cycle is over and tightening is more likely. Indeed, the SARB's own Quarterly Projection Model (QPM) projects a hike in 2Q and 4Q. While the SARB will no doubt acknowledge the much better global growth environment since it last met in March, it is not suffering the same price pressures as its EM peers. Helping that in part has been the strong ZAR, which has risen 5% on a trade-weighted basis since March. The commodity boom and terms of trade gains is the driving story here, keeping the trade balance stronger for longer. Without the same need to address price pressures, the SARB may be reluctant to be rail-roaded into the hawkish shift of EM peers. That might not be taken well by the markets initially, but we suspect ZAR buyers would emerge were USD/ZAR to correct to the 14.18/25 - given the conviction behind the commodity story.

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