

## FX Daily: Riksbank needs to show the krona some love

The central message coming from this week's Sintra conference is that economies are holding up better than expected, the decline in inflation has been frustratingly slow and more tightening needs to be done. Expect the dollar to stay bid ahead of what should be another high US core inflation print tomorrow. Elsewhere, the Riksbank is expected to hike 25bp



### USD: No reason to fight dollar strength this week

Central bank communication at this week's Sintra conference in Portugal has stayed pretty hawkish. The core message seems to be that low unemployment rates have allowed economies to withstand large tightening cycles reasonably well, meaning that inflation has not fallen as much as expected. Expectations for the duration and terminal rates for tightening cycles are being revised higher. This is most credibly being done in the US, where the economy appears to be outperforming.

This is allowing the dollar to stay quite bid - especially against those currencies without much/any interest rate difference such as the Japanese yen and the Chinese renminbi. On the latter,

policymakers are gently trying to fight the steady move higher in USD/CNY by setting lower fixings. However, they may be forced to cut the required reserve on FX deposits as they did last September if they want to send a stronger message of displeasure over renminbi depreciation. And as we have seen over the years, a steady uptrend in USD/CNY is not conducive to an overall bear trend in the dollar.

Back to the Fed. If central banks are increasingly data-dependent, what's next in store for the Fed? The most important data point of the week will be tomorrow's release of the core PCE deflator for May expected at 0.3/0.4% month-on-month. Presumably, investors will be a little long dollars going into that release. Before that, however, we today see the weekly initial jobless claims figures. These have recently settled at higher levels. Any big upside surprise here could knock the dollar intra-day on the view that tighter policy is finally easing up labour supply - a key shoe to drop in the fight against inflation.

DXU looks biased to 103.30/35 and possibly 103.65 - as long as initial claims do not spike higher today.

*Chris Turner*

## ➔ EUR: Looking at June national CPIs today

Hawkish rhetoric from European Central Bank President Christine Lagarde this week has failed to move the needle much on market pricing of 25bp hikes in July and September. Let's see whether those expectations change much on the release today of national CPI data in both Germany and Spain. These are a precursor to tomorrow's release of the eurozone CPI figure, where the core rate is expected to tick up to 5.5% year-on-year from 5.3%.

The difference between the US and the eurozone story, however, is the confidence and activity data. Today, the eurozone is expected to release another soft set of consumer and industrial confidence data for June. This leaves a lingering sense that the ECB's hawkishness could crumble before the Fed's.

With USD/CNY staying bid and eurozone data soft we would say EUR/USD risks another drop to the 1.0850 area. Valuation metrics suggest EUR/USD does not have to sell off too far - but the pieces of the investment puzzle have yet to fall into place for a EUR/USD rally.

*Chris Turner*

## ➔ GBP: Some underperformance

The Bank of England's broad trade-weighted index for sterling has barely budged since last Thursday's 50bp BoE rate hike, where sterling strength against some currencies presumably makes up for some modest weakness against the dollar and the euro. 10-year UK gilt yields - which had briefly fallen on the large hike - equally have barely budged. Where sterling bears may find some solace is that UK large and mid-cap equities have only rallied 0.7% this month - compared to 3% gains for their European peer group.

In short, we think it is too soon to start selling sterling on hard landing fears. We think sterling only sells off when the data - both inflation and labour market data - suggest the BoE can ease up in its hawkishness. Until then GBP/USD might find some support near 1.2600 and EUR/GBP could easily drift back under 0.8600.

Chris Turner

## 📌 SEK: A high wire act for the Riksbank today

EUR/SEK remains close to historic highs as the Riksbank prepares to announce a key monetary policy decision this morning. As discussed in our [meeting preview](#), the performance of the krona is a primary source of concern for the Bank, but also a relatively “self-inflicted” pain. The dovish shift at the April meeting – when two Board members voted against a 50bp hike – left the krona unshielded from risk sentiment dynamics and above all, mounting domestic risks (particularly those related to a troubled property market).

The key question today is whether the hawkish rhetoric that had supported the krona into April will somehow be rebuilt. Market pricing suggests a 50bp hike had been factored in the weeks leading to today’s announcement (a peak of 40bp was reached last week), and the OIS curve now prices 35bp for today and 46bp in total by the September meeting. We think that the recent financial turmoil hitting property company SBB and the more general fragile state of Sweden’s economy and property outlook would argue against a 50bp hike today, but we cannot fully rule it out.

To prevent another SEK drop, a 25bp hike would need to be accompanied by signals in the rate forecasts and in the statement that the bank is ready to hike rates further. Another option – which has actually been hinted at by one of the dovish dissenters – would be to accelerate the pace of quantitative tightening. That should be a preferred solution to the third option – FX intervention – which may prove unsustainable and unsuccessful. We suspect there are limitations to the currency impact of faster QT, which would squeeze the back-end of the SEK curve but may leave the EUR-SEK short-term rate differential too wide (considering how hawkish the ECB is) unless the Riksbank pushes forward some rate hike pledges.

Expect EUR/SEK volatility today: we suspect there are some upside risks and a move to the 11.85/11.90 level is possible as the Riksbank may fail to make a structurally SEK-bearish market change its mind. By contrast, should we see a resolutely hawkish tone, EUR/SEK may slide back below 11.70. As we have learned from the April meeting, the spectrum of surprises can be quite wide with the Riksbank.

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