

FX Daily: Still searching for the light at the end of the tunnel

FX dynamics are set to remain strictly tied to developments in global equity markets, which are desperately seeking some stabilisation after a rough period. Domestic stories should play a secondary role, although some focus will be on key data releases in the UK and Australia. EUR/USD remains at risk of a break below the 1.0340 support



➔ USD: All about risk sentiment

Risk assets are desperately seeking some stabilisation after seven consecutive weeks of losses in US equities and exacerbating market concerns over the combination of a global economic slowdown and monetary tightening. Asian equities are mixed this morning, while futures point to another negative open for most European and US stock indices today.

In the FX market, the main implication of this period of risk instability has been a weakening of the link between short-term rate differentials and currency dynamics, as the liquidity factor (Norway's krone, for example, is the least liquid currency in the G10) as well as the exposure to the two epicentres of market risk – the Russia-Ukraine war and China's lockdowns – have played a much

bigger role.

In such an environment, the dollar has remained firmly in demand, and we doubt we are going to see a rapid and material unwinding of defensive dollar positions in the week ahead. Even though rates are now a secondary driver to risk sentiment, recent data has all but endorsed the prospect of more aggressive tightening by the Fed, which is inevitably contributing to building a floor under the dollar. This week does not include any major data releases in the US, but retail sales, industrial production and housing figures should broadly confirm that the US economy remains in a good place. The Fedspeak calendar includes some scheduled remarks by Chair Jerome Powell on Tuesday, as well as other FOMC speakers.

Our economics team has recently revised its Fed forecast higher and now expects three consecutive 50bp rate hikes (June, July, and September) before a return to quarter-point raises in November. [Here are ING's latest views on global central banks.](#)

We might see some tentative stabilisation in risk sentiment this week, which could favour a partial recovery in high-beta currencies and put a cap on the dollar upside for now. That is, however, far from assured given the volatility we have seen in recent weeks. More risk-off waves would likely push DXY well above 105.00.

➔ EUR: Still struggling

EUR/USD remains close to a key technical level, the 1.0340 multi-year low. A break below such a level would likely pave the way for another leg lower and make parity quite a tangible possibility. We are marginally inclined to think the euro will be able to hold above 1.0340 this week, given quite a lot of short-term negatives are now in the price, and possibly climb back to the 1.0500 gravity line. This scenario, however, heavily relies on some stabilisation in global risk sentiment.

The discussion among EU members over the commodity-centred dispute between Brussels and Moscow progressed over the weekend, as the European Commission reportedly offered a solution to European companies buying gas from Russia in order to comply with Russia's requirement for ruble payments without breaking EU sanctions. Today, EU's foreign ministers will meet to further discuss an EU-wide ban on Russian oil, as Hungary continues to oppose the move arguing it would be too damaging for its economy. The oil ban is mostly priced into the euro already (Germany pledged it would go ahead with the ban even without the rest of the EU) and we doubt an official announcement this week would generate a dramatic drop in the currency.

Today, we'll see the updated economic projections from the European Commission, which should include a cut to the 2022 eurozone's growth from 4% to 2.7%, and an upgrade in the inflation forecast to 6.1% this year. For the rest of the week, the data calendar in the eurozone is quite quiet, but some focus will remain on European Central Bank speakers. We'll hear from Philip Lane, François Villeroy and Fabio Panetta today, and from President Christine Lagarde tomorrow. The impact of ECB members' comments on the euro should, however, remain quite limited given the prevalence of risk sentiment in FX.

➔ GBP: Data releases in focus this week

It will be worth keeping an eye on data this week in the UK. Tomorrow, jobs figures should keep pointing to a tight labour market and potentially some marginal acceleration in wage growth. On Wednesday, the April inflation report should show a jump in the headline rate above the 9.0%

mark (so a 2.5%+ month-on-month reading) while the core rate should rise above 6.0%.

Still, we suspect the monetary policy implications of these readings may be quite contained given that the Bank of England's latest forecasts already embed double-digit inflation later this year. We are not even convinced inflation will accelerate to that point, although CPI figures have consistently surprised to the upside recently. Our economics team thinks the BoE will only hike two more times this year (June and August, by 25bp each) and before pausing. Today, Governor Andrew Bailey and other MPC members will answer questions from the Treasury Committee.

The battered pound is largely hanging onto some recovery in risk appetite to extend Friday's marginal rebound. However, markets will also keep a close eye on Brexit-related developments, which may end up generating more downside pressure on the currency. The risks of a move to 1.2000 in GBP/USD in the near term remain very material.

➔ AUD: Some key data to watch before the elections

The Aussie dollar has started the week on the backfoot after China reported weaker-than-expected industrial production and retail sales data for April, and the People's Bank of China refrained again from cutting its Medium-Term Lending Facility Rate – possibly signalling some concern over an excessively sharp depreciation in the yuan. All this seems to have overshadowed the news of a gradual easing in some restrictions in Shanghai.

This week is packed with market-moving events in Australia. Tomorrow, the minutes from the Reserve Bank of Australia's May meeting will be scanned closely for hints about the timing and size of additional monetary tightening. On Wednesday, the long-awaited wage data for 1Q will be released. This has previously been highlighted by the RBA as the key piece of data needed to start the tightening cycle. Ultimately, price pressures forced an earlier move but evidence of fast-accelerating wage inflation would probably raise the chances of faster tightening. On Thursday, the employment figures for April will be published, with a chance the jobless rate will fall below 4.0%.

Australia's Federal elections will be held on 21 May, although early voting has been active for a week and is set to represent a record-high percentage of total votes. The latest opinion polls see the incumbent prime minister Scott Morrison's Liberal-National coalition trailing about 3% behind the centre-left Labour party.

Still, we think AUD will remain tied to global risk sentiment and China-related developments, and the impact of domestic factors may be rapidly offset by external factors. Some recovery in global equities is surely needed at this point for AUD/USD to climb back above 0.7000, while another risk-off wave could send the pair to the 0.6600-0.6700 area in the near term.

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