FX Daily: Surprise hike from the SNB today?

The dollar is consolidating after yesterday's well-flagged 75bp hike from the Fed. US yields fell sharply from intra-day highs after Fed Chair Powell said that 75bp hikes would not be common. Yet the Fed wants policy rates in the 3.00/3.50% region by year-end. This should keep the dollar near the highs this summer. Look out for BoE and SNB meetings today

USD: Expect dollar to remain bid on dips

As James Knightley discusses in [his review of the Fed meeting](), the Fed looks likely to go again with a 75bp hike in July. The sharp adjustment in short-dated US yields and the dollar after Powell said that 75bp adjustments would not be common looks more a function of market positioning than any serious re-assessment of the Fed rate cycle. After all, Powell also said he wants the policy rate at 3.00-3.50% by year-end (3% is pretty high for a reserve currency) and the Fed dots tell us that the policy rate could be closer to 4.00% by the end of 2023. With inflation proving sticky this summer, there seems no reason for the Fed to back away from this hawkish messaging over coming months. That should keep the dollar supported on dips.

The argument for some dollar correction comes from the pricing of the Fed terminal rate having stalled near 4.00% and peer group central banks playing catch-up. One of the biggest event risks now is tomorrow's Bank of Japan (BoJ) meeting. The BoJ's policy of trying to keep 10-year JGB yields in a +/- 25BP range around zero has been under heavy pressure this last week on the bond market sell-off. The dovish BoJ under Governor Haruhiko Kuroda may not be tempted to alter policy on market pressure, yet that would probably now send USD/JPY sharply through 135 and prompt the Japanese Ministry of Finance to order intervention. Needless to say, Japan's monetary policy is a major source of market volatility.

An additional factor favouring some dollar consolidation could be the temporary support to be found by equity markets into the end of June - as buy-side portfolio managers re-balance portfolios into equities. If that is the case, we would prefer high-beta currencies outside of Europe to perform better - e.g. the Canadian dollar and the Mexican peso, while European FX will continue to be dragged by the energy shock.

For today, some softer US housing starts could drag the dollar a little lower, but a hawkish Fed should keep it bid on dips. DXY should find support around the 104.50/60 area.

EUR: Gas prices prove a drag

EUR/USD is consolidating above the lows of the year at 1.0350/60, but developments in European natural gas markets have probably prevented a bigger rally on the back of the softer US yield story yesterday. Here, the focus is on Russia cutting gas supplies to Germany and Italy by up to 60%, blaming maintenance issues. European natural gas jumped 30% yesterday and is a reminder of the frontline risks to Europe posed by the war in Ukraine. This came on the day the eurozone announced a record monthly trade deficit (EUR32bn in April) and references our medium-term valuation work that the terms of trade adjustment on the energy shock has damaged the euro's fair value. Our conclusion is that even at these levels, EUR/USD is not cheap.

With gas prices on the move, EUR/USD may well trace out a 1.0350-1.0500 range near term and fail to benefit as much as others from any corrective rallies in equities. Additionally, news on the anti-fragmentation scheme from the ECB has not made a material benefit to the euro - serving as a reminder that the euro faces a plethora of challenges at the moment.

GBP: 25bp from the BoE and no day of reckoning

Our UK economist, James Smith, looks for a 25bp hike from the Bank of England (BoE) today, taking the Bank rate to 1.25%. The market prices the Bank rate at 2.80% by the end of this year. Most of us think that at some point there will be a 'day of reckoning' for sterling when the BoE aggressively wants to correct market expectations. But we do not think that will be today. Trade-weighted sterling is some 5% weaker on a year-on-year basis (perhaps adding 0.5% to headline CPI) and with inflation expected to remain high all year, the BoE may not want to trigger a further collapse in the pound.

EUR/GBP could correct back to the low 0.85s if the BoE leaves market expectations unchanged, while GBP/USD could be a pair to recover from a temporary lift in equity markets - potentially drifting up to the 1.2250 area.

CHF: Why should the SNB wait until September to hike?

The Swiss National Bank (SNB) meets today to set monetary policy. The assumption from most in the market is that, given the SNB has been fighting Swiss franc strength for over a decade now, the SNB will keep rates unchanged at -0.75%. The rationale here is that the SNB will want to see what the ECB does first (a 25bp hike in July and another 25/50bp in September) before hiking at its 22 September meeting. Out of 20 economists surveyed by Bloomberg, 19 expect unchanged rates today, with one going for a 25bp hike.

A counter-argument - and one we've heard on a recent client trip to Switzerland - is that the SNB has no option but to hike today. Its mandate is to keep inflation below 2% and inflation is now 2.9% YoY (May). The argument extends to it being insufficient for the SNB merely to highlight that rate hikes in September are possible/likely. Undoubtedly the SNB is going to have to raise its inflation forecasts today and were it to hike today, the justification would be that failing to act could see this near-term period of above-target inflation leading to second-round effects.

We have recently turned more positive on the Swiss franc based on speeches in late April which suggested the SNB wanted to keep the real CHF stable. To do this - and given Switzerland's low inflation - the nominal CHF needs to appreciate.

A hike today would certainly be a big surprise and send EUR/CHF 1-2% lower. But even if the SNB does not hike today, it does have the FX firepower (like the Czech National Bank) to strengthen its domestic currency. Our call this year is that EUR/CHF upside is limited to the 1.05 area and that the SNB, one way or another, will guide EUR/CHF to the 0.98/1.00 area over the coming quarters.

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