

## FX Daily: Surprise RBA hike gives the dollar food for thought

The Reserve Bank of Australia surprised with a 25bp hike, citing upside risks to inflation and the trade-off that delaying rate hikes could be costly. This may raise expectations for a similar move from the Bank of Canada tomorrow and that the Fed will sound hawkish next week – which may well frustrate dollar bears. Keep an eye out for Poland's rate meeting



The Reserve Bank of Australia governor, Philip Lowe

### ➔ USD: RBA hike questions whether the Fed could do something similar

The dollar opens Europe a little weaker and is about 0.5% off yesterday's highs. The sharp drop from those highs came on the back of the [softer May ISM services data](#), where both activity and price levels supported the US recessionary narrative and further questioned the quality of Friday's strong NFP jobs report. However, the US data calendar is now pretty quiet for the rest of this week and the market may well hold positions into next week's May CPI data and the June 14th FOMC meeting.

Delivering some food for thought ahead of that FOMC meeting was last night's [surprise hike by the](#)

[Reserve Bank of Australia \(RBA\)](#). Having paused its aggressive hiking cycle in April, the RBA hiked another 25bp, citing increased upside inflation risks and – like many central banks around the world – frustrated that core inflation was not falling more quickly. The RBA's move to restart its tightening cycle may throw extra focus on tomorrow's Bank of Canada (BoC) meeting after paused rate hikes at its March and April meetings. A 25bp BoC rate hike tomorrow (now priced with a 43% probability) would probably cause ripples across core bond markets around the world and could keep the dollar bid on the view that the Fed might be closer to hiking than first thought. Let's see.

So while the dollar is slightly offered today, we think investors may be reluctant to rebuild dollar shorts until next week's double event risk of CPI/FOMC has been overcome. In the meantime, FX volatility levels continue to sink and the high yielders – especially the EM high yielders – are in demand. It is no doubt a crowded trade, but there is still a lot to like about the Mexican peso which offers 12.5% implied yields through the three-month forwards.

DXY should trade well within a 103.50-104.50 range today.

*Chris Turner*

## ➔ EUR: Volatility sinks

Both traded and realised volatility levels in EUR/USD are dipping back to pre-invasion levels in February 2022. Despite tight liquidity conditions, FX markets are taking their cue from the rates market. Here, measures like the MOVE index – a yield curve weighted index of 1-month US Treasury implied volatility -- have fallen to the lowest levels of the year, presumably on the view that the Federal Reserve will not be doing a lot with the policy rate over the coming months.

In other times, low volatility might have seen the dollar used as a funding currency for pro-cyclical trades. However, 5% overnight deposit rates make the dollar far too expensive to be a funding currency. This serves as a reminder that we need to see genuinely soft US data – particularly price data – and for the Fed to respond to it in order to see the dollar embark on a major cyclical bear trend. The steeply inverted US yield curve tells us that we are not at that point yet.

With US two-year yields holding onto around three-quarters of their rise since Friday's jobs report, it may be too early to expect EUR/USD to add to yesterday's gains. EUR/USD may trade well within a 1.0680-1.0780 range into tomorrow's Bank of Canada meeting. It may also take its cue from this week's China data, including May trade data released tomorrow and aggregate financing data later in the week.

*Chris Turner*

## ➔ GBP: A lot more focus on the mortgage time bomb

The UK press is spending a lot more time focusing on the UK mortgage time bomb, where 600,000+ mortgage holders are due to refinance in the next six months and could find themselves paying 400bp more in interest on their mortgages. So far, this threat to the UK consumer has yet to show up in the pricing of the Bank of England cycle, where the Bank Rate is still priced some 90bp higher at 5.40% by year-end.

In EUR/GBP, 0.8550 has been the best level of the last year for sterling (EUR/GBP bounced off 0.8565 last week) and we doubt investors want to chase sterling through those levels anytime soon. GBP/USD is consolidating in a 1.2350-1.2550 range and should stay there if we are correct

with our EUR/USD call.

*Chris Turner*

## CEE: NBP starts thinking about rate cuts again

Today, we have a number of hard data on the calendar in Romania, Hungary and the Czech Republic. Industrial data in the Czech Republic should be the main focus, confirming the weakness of the economy. Later today, we will see a decision from the National Bank of Poland. We **expect**, in line with the market, that rates will remain unchanged, so the statement released later may be more interesting.

However, we will get the main portion tomorrow during Governor Adam Glapinski's press conference. The May inflation number fell from 14.7% to 13.0% year-on-year, below market expectations, and even the outlook for further disinflation is better than previously thought. The governor can therefore be expected to raise the topic of rate cuts later this year again. Although this is not our baseline scenario, our economists see an increasing likelihood of such a move. The market at the moment is pricing in roughly 80bp of cutting this year and roughly 150bp by the May meeting next year. That is more than we expect, but markets can be expected to accept the governor's dovish narrative and be open to pricing in even more easing for now.

Despite our expectations yesterday, the whole region strengthened and the positive mood after the US payroll numbers seem to have prevailed over the decline in interest rate differentials. We can expect this direction along with higher EUR/USD to support CEE FX today as well. On the other hand, as we mentioned yesterday, the Polish zloty and Hungarian forint should run into overcrowded market positioning. Therefore, we expect that the Czech koruna should benefit the most from this situation, as it can offer a more balanced market position and, moreover, has already demonstrated the highest beta against EUR/USD within the region in recent weeks, heading below 23.50 EUR/CZK for the first time since mid-May. On the other hand, a dovish NBP narrative may be seen in the Polish zloty market rather after the press conference on Wednesday only.

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