

## FX Daily: Volatility on the rise

FX markets are a little calmer after Chinese authorities promised to offer more support to the economy. But a more freely floating renminbi plus the steady withdrawal of central bank liquidity over coming months and quarters warn that FX volatility will only rise further. For today, look out for US consumer confidence data and what it means for the Fed



### ➔ USD: consolidation in store after Monday's wild ride

FX markets are calmer today after Monday's wild ride. That ride was largely caused by a re-appraisal of China, where spreading lockdowns and quite a rare, fast drop in the renminbi spread a little panic through the emerging market FX complex. That panic has subsided a little after Chinese policymakers overnight promised to deliver more monetary support (having disappointed over recent weeks) and to speed up its review of the big tech/platform economy (helping Asian tech stocks overnight). The People's Bank of China's move to cut the Reserve Requirement Ratio on FX contracts yesterday also managed to stabilise the renminbi.

The market now awaits the outcome of the quarterly Chinese politburo meeting over the next few days to see what concrete stimulus measures actually emerge.

Away from the shorter-term challenges facing China, Monday's move in the renminbi will only add to the increasing sense that FX volatility is set to rise further. One month USD/CNY realised volatility is now at the highest level since February 2021 as the Chinese authorities seemingly let the renminbi float more freely. Remember that the PBoC had kept USD/CNY in a tight 6.35-6.50 range over the last year to control against imported inflation - the side effect being that the trade-weighted renminbi had soared 11% since early 2021 - a move now being reversed.

But FX volatility will also be driven higher by the withdrawal of central bank liquidity - both by rate hikes and by quantitative tightening about to come through over coming months and quarters as central banks start to shrink their balance sheets. The FX consequences of higher volatility should be that benign carry trade strategies fall out of favour and, like yesterday, the dollar will find more friends.

For today, we are interested to see whether US data like consumer confidence has any impact on Fed expectations. Last week's raft of poor consumer data in the UK dented Bank of England tightening expectations and saw sterling crumble. Will today's release of April Conference Board consumer confidence have any impact on the pricing of the Fed cycle? We suspect not. DXY may now be due some consolidation in the 101-102 area, but the trend towards testing the March 2020 high near 103 remains intact.

## ➔ EUR: ECB tightening expectations take a hit

Monday's sell-off in European equities triggered a reasonably sharp adjustment in European Central Bank tightening expectations. Having priced 85bp of ECB tightening by year-end last Friday, those expectations have dropped to just 72bp. And as we suggested last week, the ECB debate over whether it hikes 50bp, 75bp or 100bp this year is being rather swamped by the potential 250-300bp adjustments to be made elsewhere in the world.

Developments in Ukraine are also at a dangerous phase. Russia now seems to be targeting Western military aid for Ukraine more directly with attacks on rail infrastructure, questioning whether attacks move closer to the border with NATO partners. Escalation is clearly a risk. For today, however, EUR/USD can consolidate in a 1.07-1.08 range before making a move towards the March 2020 low at 1.0635.

Elsewhere in Europe, the National Bank of Hungary looks set to raise its [base rate by 100bp today](#). A calmer EUR/USD environment could see EUR/HUF dip back to the 370 area (after all the forint is an expensive sell with implied yields over 6%). Yet geopolitics will prevent it from returning to the 360 area.

## ➔ GBP: picking up the pieces

Sterling continues to trade on a fragile footing after some consumer data put a dent in the Bank of England (BoE) tightening story. Most now feel that GBP/USD has to test 1.2500, and 1.2850 will now act as strong resistance - should it get that high. Tightening expectations for the 5 May BoE meeting have dropped backed to 29bp from 38bp early last week. However, by December, Bank Rate is still priced at 2.17%.

For us, one of the key stories this year will be whether central banks push ahead with tightening even as growth slows. That will clearly deliver flatter or inverted yield curves, but could actually see currencies staying strong. So until the BoE waves the white flag on the rest of its tightening cycle,

we think it may be too early to write off sterling - particularly against the euro. Don't be surprised if EUR/GBP sinks back into a 0.8300-0.8400 range.

## ↓ BRL: most exposed

At one point yesterday, USD/BRL was nearly 3% firmer, following a 3% rally on Friday. After a stellar rally this year on the commodities story, we now think the Brazilian real is entering a vulnerable period. The key risk here is one of equity outflows after about US\$18bn flowed into Brazilian equities - heavily weighted to the materials sector - over the last four to five months.

The Fed driving real US interest rates into positive territory to battle inflation and a difficult external environment mean that those equity flows into Brazil are subject to reversal. At the same time, Brazil's central bank is close to the end of its tightening cycle (near 12.75%) and the Brazilian presidential election will be hotting up. Brazilian growth near 0.5% this year leaves plenty of room for last-minute fiscal adjustments - typically the Achilles Heel of Brazilian asset markets and still a concern for Brazil's central bank.

We have quite a bearish set of [BRL forecasts this year](#) and remain happy with those.

### Author

#### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

#### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

#### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the

Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).