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FX TALKING

FX Talking: Summer of discontent keeps dollar in demand

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Executive summary

The global economy can now be characterised as one in which many central bankers are poised to hike rates more forcefully, even as growth prospects are being revised lower. Investors are now having to ask which economies can best withstand these tighter monetary conditions and which currency to back?

During this summer of discontent the answer to these questions largely remains the US economy and the dollar. Unlike the supply-driven inflation suffered in Europe, price rises in the US are far more a function of demand-side factors and suggest stagflation is less of a likelihood in the US than in Europe. And with no end in sight to tight energy markets, the US remains better positioned here too.

We expect the Fed to deliver at least another 175bp of hikes this year as the Fed drives

real US interest rates into restrictive territory. This is not good news for global growth – but that is the point, the Fed needs to slow demand. Flatter yield curves consistent with the latter stages of the US business cycle are normally good news for the dollar.

In all this means that the dollar should stay bid this summer (1.00/1.02 is possible in EUR/USD), while USD/JPY in the 135/140 region looks ready to trigger Japanese intervention. GBP/USD can move to the low 1.20s as the BoE cycle is repriced lower and the CHF should start to outperform in Europe as the SNB guides it higher. CEE FX has become more mixed. We still favour the PLN, but HUF and now CZK look more vulnerable.

This will be a fragile environment for most EMFX – especially those most exposed to China. Here USD/CNY can still push higher taking most of \$/Asia with it.

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