**Hawkish Fed pushes dollar to two-year high**

Market Report 25/04/22 - By Sam Balla-Muir

**USD**

The main story in currency markets last week was the further strength in the US dollar. It rose against all other G10 currencies bar the Swedish krona, gained around 0.1% against the euro, and nearly 1.7% against the British pound. One factor pushing up the US dollar last week was probably concerns about the health of the global economy, reflected in the roughly 3% drop in global stock markets last week. However, the other factor pushing up the US currency was comments from a raft of Federal Reserve officials – including James Bullard, Mary Daly, and Chairman Jerome Powell – suggesting that the US central bank will double down on its plans to raise interest rates aggressively in order to bring high US inflation back under control.

With a large amount of interest rates already discounted in the US, the dollar has now risen some way. The DXY index, a broad-based measure of the US currency's strength, rose last week to its highest level in more than two years. Even so, I suspect that the US dollar will make some additional gains over the coming months, as the Federal Reserve raises interest rates by even more than is currently anticipated. After all, with the US economy so strong and its financial markets still relatively robust, it looks set to require a lot of monetary tightening to bring US inflation back down. The Fed's next policy meeting, which concludes on May 4th, could prove to be a trigger for further US dollar strength.

**GBP**

The British pound struggled last week, falling by around 1.7% against the US dollar and by only a bit less against the euro. While this was partly a reflection of factors propping up the US dollar and euro, respectively, sterling faced its own domestic headwinds. One is the re-emergence of Brexit risks, with Westminster reportedly mulling a law that would allow UK politicians to unilaterally make changes to the Northern Ireland protocol. The other factor was weak economic data, with data showing that a 0.5% fall in retail sales in February was followed by a 1.4% decline last month, and the Flash PMI business surveys for April weakening in the UK too.

The risks to the pound from UK politics are always a wildcard, and many a currency trader has lost their shirt betting on the direction in which Brexit news will take sterling. But, in my view, the recent weakness in the pound from the poor economic news seems overdone. While the economic data last week pointed to soft activity, both releases also suggested that price pressures in the UK remain very strong. With that in mind, I doubt that weak economic growth will do all that much to persuade the Bank of England to dial back on its own plans to raise interest rates. That suggests to me that the pound's fortunes could improve over the coming months, strengthening against the euro, if not against the US dollar.

## EUR

After a poor recent run, the euro held up quite well last week, rising by around 1.6% against the pound, and falling by only around 0.1% against the US dollar. The euro's strength is probably due in part to investors easing concerns about a Marine Le Pen victory in Sunday's second-round French presidential election, with the exit polls released late last night confirming the that Emmanuel Macron has secured a second term, and Madame Le Pen conceding defeat. However, the euro was also supported by comments from the European Central Bank's second in command, Luis de Guindos, that the Bank might begin raising interest rates in March, sooner than investors had anticipated.

The euro seems unlikely to get much of a boost this coming week on further relief about the French election outcome, given that a Macron victory was more or less priced in by the end of last week. And looking further ahead, I suspect that the Eurozone's currency will generally weaken over the next few months. Its economy appears weak, and while inflation is also high on the continent, there it seems more likely to be a passing phenomenon. With that in mind, I think that the European Central Bank will disappoint those investors expecting very rapid rate hikes.

## The Week Ahead

The coming week looks set to be a quieter one, with the customary "blackout weeks" before policy meetings meaning that no Bank of England or Federal Reserve officials will provide market-moving comments on monetary policy next week. There is limited economic data of note in the UK, though first quarter GDP data in the Eurozone due on Friday look set to show that its economy barely grew.

Otherwise, US data on first quarter GDP and personal income & spending in March – due on Thursday and Friday, respectively – may paint a more upbeat picture.

**Last Week's Changes In Exchange Rates**

| Exchange Rate | %- change on week |
|---|---|
| € per £ | -1.56 |
| $ per £ | -2.50 |
| $ per € | -0.11 |

**Key Events**

| Date | Market | Time (GMT) | Release/Event | Period | Previous | Analysts' Expectation |
|---|---|---|---|---|---|---|
| Thu. 28th | US | 13.30 | GDP (% Q/Q Annualised) | Q1 | +6.9% | +1.2% |
| Fri. 29th | EZ | 10.00 | GDP (%Q/Q) | Q1 | +0.3% | +0.3% |
| Fri. 29th | US | 13.30 | Personal Income (%M/M) | Mar. | +0.5% | +0.5% |