FX Daily: A hawkish 'skip' by the Reserve Bank of Australia

The RBA decided to focus on decelerating inflation rather than the strong labour market and kept rates on hold overnight. Still, it reiterated a data-dependent approach and signalled openness to more tightening ahead. In general, it should be a quiet day in FX today due to the US national holiday, but things will get hectic again from tomorrow

The Reserve Bank of Australia, Sydney

USD: National holiday today, but volatility to pick up from tomorrow

The week has started without very clear direction dynamics in dollar crosses, largely due to reduced flows in US markets around the Independence Day holiday: US bond and equity markets are closed and there are no data releases, so expect another quiet day in FX.

Yesterday, the ISM manufacturing index was released and came in at 46.0, below consensus expectations. The print was in contractionary territory (i.e. below 50) for the eighth consecutive month and hit its lowest level since May 2020. It's worth noting that ISM manufacturing has been a historically accurate leading indicator of GDP dynamics and it currently points to a substantial slowdown.

This week, markets will once again need to filter their rate expectations for the evidence offered by data releases in the US. The reaction to the ISM manufacturing index has been limited due to reduced volatility around the US holiday, and also because the ISM services (out on Thursday) has been a bigger market mover. USD-crosses volatility will pick up again tomorrow when the focus will shift to FOMC minutes.

Francesco Pesole

EUR: Sticking to 1.09 for now

The data calendar is quiet also in the eurozone today. EUR/USD appears to have found an anchor around 1.0900, which likely signals some reluctance for markets to take the pair sustainably above the benchmark 1.10 level, given uncertainty about the Fed's tightening peak, but still mirroring the support offered by the very hawkish ECB messaging.

The only speech by ECB officials scheduled today is one by Joachim Nagel, who already delivered some hawkish remarks yesterday, saying the tightening cycle has still some way to go given upside risks to the risk outlook.

Francesco Pesole

AUD: Another skip by the RBA

The Reserve Bank of Australia (RBA) kept rates unchanged overnight, as expected by the OIS market which was attaching a 20% implied probability of a hike before the meeting. Once again, policymakers have decided to attach greater importance to the monthly inflation reading (May's CPI slowed from 6.8% to 5.6% year-on-year) than to jobs market figures (the latest print was very strong).

Still, the statement clearly leaves the door open for more tightening if required and reiterates a strictly data-dependent approach to further monetary policy decisions. Today's hold is explicitly referred to as needed to provide the Board with "more time to assess the state of the economy and the economic outlook and associated risks".

As noted by our economics team in a note released overnight, September could be a better occasion for the RBA to increase rates again, as it can assess the impact of large electricity tariff increases due in July, which should become visible in CPI figures by September.

Markets are actively speculating on further RBA tightening and the initial drop in AUD/USD after the hold is already being reverted. With a September rate hike almost fully priced in, we expect the pair to be almost entirely driven by external factors (Fed, US data, Chinese sentiment): for now, the upside looks somewhat limited, although the room for a rally later in the year should emerge.

Francesco Pesole

CEE: Gas prices as a window to a cheaper forint

Today's calendar in the region is basically empty and thanks to the US holidays we can expect lower activity in the CEE region as well. Yesterday's trading ended with a weaker forint and flat koruna despite our expectations.

As we mentioned yesterday, gas prices have once again become a strong driver for HUF and CZK in recent weeks. Yet, at the end of yesterday's trading, a decline in gas prices was already observed after the end of some seasonal work in Norway which limited the capacity of flow. Gas flow is thus slowly returning to normal and in our view it is too early to worry about storage levels in import-dependent countries such as Hungary and the Czech Republic ahead of the upcoming winter.

We thus see the current depreciation of the HUF and CZK as temporary and, especially in the case of Hungary, we expect the market to take the opportunity to buy the forint at a discount and benefit from the still massive carry.

In addition, June inflation in Hungary will be published on Friday, which we think has a good chance to surprise to the downside compared to market expectations. Yet, in the last three months, lower inflation has been a signal for the market to buy the forint as confirmation that things are returning to normal in the country with the highest inflation in Europe. Overall, we still expect the forint to return to 370 EUR/HUF by the end of this week.

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