FX Daily: A hike, a hold and a cut

There are two close central bank calls this week: the BoJ, which we narrowly expect to hike by 15bp, and the BoE, where our call is a 25bp cut. We expect the Fed to hold rates but it may lay the groundwork for a September cut. We see EUR/USD ending the week moderately higher, while we see the yen outperforming again and expect sterling to depreciate

Fed Chair Jerome Powell and Bank of England Governor Andrew Bailey. We expect a hike in Japan, a hold in the US and a cut in the UK this week

USD: Downside risks this week

Central banks and macro data have taken an unusual secondary role for FX markets as US politics, stock markets turmoil and some sizeable positioning adjustments (carry trades, JPY) generated volatility in some pairs inconsistent with macro developments. We'll see whether month-end flows offer some respite to the battered high-yielding currencies, even though the carry trade unwinding may continue this week if we are right with our call for a 15bp Bank of Japan rate hike on Wednesday.

While we admit it is a very close call, and markets are pricing in only 6bp, the BoJ may want to contribute to re-strengthening the yen and is probably concerned about stronger-than-expected wage growth. We also expect a reduction in the bond-buying programme. USD/JPY could then prove to be one of the biggest movers in FX again. The 200-day moving-average support at 151.5

could be tested near term and a break lower can pave the way for a move to 150.0.

In the US, the two main events of the week are the FOMC rate announcement on Wednesday and the July jobs report on Friday. In our Federal Reserve preview, we discuss why there are some downside risks for the dollar this week. The June dot plot projections look unreasonably hawkish given the recent data flow and market pricing, and we expect the Fed to pivot towards a more dovish stance in line with recent commentary and in anticipation of a potential September cut. We must remember that the FOMC has a dual mandate and even if there is no conclusive evidence of disinflation yet, unemployment at 4.1% is already above the Fed's year-end projections, and we believe policymakers want to avoid unnecessary stress on the economy.

Indeed, markets are already pricing in easing quite aggressively in the US. A September cut is fully factored in and 68bp in total is expected by year-end. We can surely see markets adding easing bets across the curve following a dovish hold – perhaps fully pricing in three cuts by year-end – but we admit there is a chance that Fed Chair Jerome Powell errs on the side of caution and delivers a less dovish (and USD-positive) communication package this week.

Anyway, when adding the downside risks from jobs figures on Friday and a potential surprise hike by the BoJ, we have a bearish bias on DXY this week, and wouldn't be surprised to see a move below 104.0.

Francesco Pesole

EUR: Growth and inflation data in focus

We think EUR/USD can trade on the strong side this week on the back of the US events discussed above. One-month historical volatility on the pair is now back at the 2024 lows, as the euro has been broadly unresponsive to both soft domestic surveys and the equity and carry trade-driven positioning adjustments in FX. However, if something can shake EUR/USD from this mid-summer low-volatility torpor, that should be the Fed and/or US data.

Some tier-one figures in the eurozone are also due this week. The second quarter GDP report tomorrow is expected to show still-tepid 0.5% year-on-year growth, but it will be the flash CPI estimate on Wednesday that should have a greater market impact. The latest European Central Bank meeting has put greater emphasis on data dependence as President Christine Lagarde ditched forward guidance. The expected slowdown from 2.9% to 2.8% in July's core CPI should not be enough to lead markets to price in more than the 55bp of 2024 easing already in the EUR OIS curve. Incidentally, core inflation has beaten consensus in five of the seven flash estimates since the start of the year.

In the rest of Europe, we'll continue to monitor closely NOK and SEK, which recently faced a huge sell-off that looks overdone to us by a number of metrics (read more in this article). We continue to expect downward corrections in EUR/NOK and EUR/SEK, with the Norwegian currency probably having more room to recover given a stronger rate profile and fundamentals. In Sweden, second quarter GDP surprised on the downside this morning, falling 0.8% quarter-on-quarter and probably keeping pressure on the Riksbank to cut rates despite a weak krona.

Francesco Pesole

GBP: Bracing for pound depreciation

The consensus among economists has recently shifted in favour of a Bank of England rate cut at the upcoming policy meeting on Thursday. This has been our longstanding view, and our UK economist discusses here why the sticky services CPI may not be a hindrance to easing. It is a close call, but we expect a 6-3 vote split in favour of a 25bp rate cut.

Markets have remained more hawkish than consensus, having kept the pricing for the August meeting within 14bp for the past month, and are currently expecting 13bp. We think there is some mispricing also on the year-end tenor, which currently sees 52bp of cuts against our call for 75bp. If the BoE does cut this week, then expectations may shift for two extra moves (three in total) in the Sonia curve, potentially dealing a substantial hit on the pound.

We had already seen reasons for a contraction in GBP/USD and a rally in EUR/GBP based on inconsistencies with rate differentials. We think that some USD weakness can limit Cable's downside, and favour EUR/GBP to display weakness in the pound this week. We still believe that a move to 0.850+ would be entirely warranted in the near term.

Francesco Pesole

CEE: Hawkish CNB will support CZK

After a rather quiet week, we have a busy calendar for the CEE region once again. Tomorrow we will see flash GDP numbers for the second quarter in the Czech Republic and Hungary. In the Czech Republic, we expect an acceleration (0.5% QoQ/0.6% YoY) from the first quarter. This should mainly be due to household consumption, but even so, momentum remains by far the weakest in the CEE region. In Hungary, we see a slight slowdown from the first quarter but an acceleration in YoY terms with 0.6% QoQ/2.3% YoY.

On Wednesday, July inflation in Poland will be released, which will show the effect of the energy price cap removal effective from 2022. We estimate the overall impact on CPI was 1.3-1.5 percentage points. That means headline inflation, which has been close to target, probably jumped to 4.5% YoY. Thursday will see PMIs across the region, which should confirm the negative sentiment in the industry.

The Czech National Bank meets on Thursday. We expect a slowdown in the pace of rate cuts from 50bp to 25bp, which would result in 4.50%, which is the market consensus as well. The central bank will also release a new forecast which may show a few changes. For more, see our CNB preview.

The main focus this week should be on EUR/CZK and the CNB decision. The market remains on the dovish side, with a high chance of a 50bp cut also on the table. So in our view, the 25bp cut should be the trigger for a CZK rally, and we are bullish here. We already see the rate differential improving in favour of the CZK ahead of the CNB meeting, which could lead to further gains – but only with the central bank's decision will we likely see more with the potential to go to or below 25.00.

Frantisek Taborsky

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com