

FX Daily: Calm ahead of the ECB

There is some tentative stability in markets after the sell-off on Monday. We look for calmer trading in FX markets today ahead of the European Central Bank meeting tomorrow. The recent dip in sterling brought EUR/GBP into overvalued territory, suggesting limited room for more pronounced upside from here



➔ USD: Tentative stability

Markets have tentatively stabilised after the sell-off on Monday, with most Asian equity indexes modestly up overnight and the 10-year US Treasury yield back above the 1.20% level. Concerns about the Delta variant and its impact on the global growth outlook are clear, but a non-negligible adjustment in risk assets has already happened while the growing risk of a dovish ECB tomorrow (which could offer some support to cyclical FX) suggests some calm and stability today. Generally, we see the recent dip in cyclical FX as a correction rather than a more pronounced trend and look for a recovery in higher beta currencies backed by hawkish central banks later this summer (CAD, NZD, NOK in the G10 FX space, BRL, MXN and RUB in emerging markets).

➔ EUR: Some calm before the ECB tomorrow

We expect EUR/USD to stay flat today ahead of the ECB July meeting tomorrow and the growing risk that the ECB may convey a dovish tone. This should keep upside to EUR/USD limited ahead of

the meeting. With risk sentiment tentatively stabilising and the prospect of a dovish ECB tomorrow, this should also help to halt the slide in Scandinavian FX, with the recent NOK losses being particularly pronounced.

➔ **GBP: Sterling getting cheap**

The latest GBP sell-off brought EUR/GBP to the most overvalued territory since April, with EUR/GBP currently screening 1.5% overvalued (which is just shy from the 1.5 standard deviation band) based on our short term financial fair value model. This means that the pace of the GBP decline vs the euro should ease, with EUR/GBP now approaching levels that would be described as stretched by our model. We therefore see limited scope for EUR/GBP to move above the 0.8700 level. The UK government is set to publish a policy paper on the post Brexit trade in Northern Ireland today, which is likely to put the UK on yet another collision course with the EU. This suggests that sterling's recovery back to short-term fair value is not imminent.

⬆ **CZK: Spikes in EUR/CZK to be faded**

CZK continue in its volatile trading pattern, with EUR/CZK driven by two opposing factors. On the positive side, the CNB being one of the most hawkish central banks globally is a clear tailwind for the koruna. But on the negative side, the meaningful one-way long positioning makes the currency vulnerable in times of stress and exaggerates its downside. We view spikes in EUR/CZK to levels around 25.80 as a selling opportunity as the CNB expected to deliver at least three more hikes this year should support the currency and lead to rebound – particularly vs HUF and PLN.