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FX Daily: Carry trade en vogue despite monetary hikes, pauses and cuts

Monetary policy tightening cycles are close to their peak in the G10 space, although this week should see a 25bp hike in the UK and possibly Australia too. Policy changes are more advanced in parts of the EM world, where Chile cut rates 100bp on Friday and Brazil should start easing this week too. However, low volatility looks set to remain a key driver of FX

USD: Overnight rates at 5.30% make the dollar an expensive sell

The dollar is proving quite resilient. Overnight USD rates at 5.30% are probably playing a role here. Also, evidence of a 'Goldilocks' scenario in the US is helping too, where there are further signs of disinflation even though US consumption is holding up quite well. This compares to Europe and China where business surveys remain soft and the concern is that stagnation deteriorates into contraction.

Testing the US soft-landing thesis this week will be the release of ISM surveys and Friday's nonfarm jobs report. Later today we will also see the Federal Reserve's Senior Loan Officer Survey, where we'll receive insights on lending volumes and how much credit conditions have tightened. Recall that the equivalent survey from the European Central Bank last week undermined the euro.

Some last vestiges of tightening cycles in G10 economies can be offset against developments in emerging markets. Here, Latin America saw some of the earliest and most aggressive tightening cycles during the pandemic and, on Friday, Chile kicked off easing cycles with a 100bp rate cut. Money markets seem to imply expectations of a 700bp rate cut over the next 12 months. And Brazil is expected to start easing on Wednesday with a 25bp cut. In theory, this should be good for emerging market growth prospects (and EM portfolio flows) and a slight dollar negative. The risk, however, is that rates are cut too far too fast - let's see. Also, look out today at 0900CET for any new measures from China's State Council to boost consumption (and EM growth prospects).

Despite this diverging global growth and monetary policy story, cross-market volatility remains low - perhaps as investors are now expecting prolonged pauses in core interest rate markets. This remains a negative for the Japanese yen and a positive for the high yielders including the Mexican peso and the Hungarian forint. The dollar is probably trapped somewhere in the middle here and unless we see some sharp deterioration in US activity that would favour the Fed not just pausing, but easing - the dollar can probably trade out ranges over coming weeks. DXY to trade 101.00-102.00 near term.

Chris Turner

EUR: Should we expect a growth surprise in 2Q

Comments over the weekend from ECB President Christine Lagarde that 2Q GDP releases so far have been encouraging suggest that the ECB may not be ready to abandon seemingly over-optimistic growth forecasts. Today we will have the first look at 2Q23 eurozone GDP growth data - expected at 0.2% quarter-on-quarter. A little later, flash July CPI will be released and is expected to show some further slowing in both the headline and core readings. Expectations for the ECB deposit rate at year-end have dipped from 3.95% to around 3.83% now.

We are a little disappointed that EUR/USD did not hold gains on Friday's soft US Employment Cost Index reading. As above, that may suggest US disinflation is not enough to get the dollar lower. Unless we see some downside surprises to the US activity data this week it looks as though EUR/USD can be dragged back towards the 1.0920 area.

Chris Turner

NOK: Look out for FX purchases today

At 1000CET today, Norges Bank announces its daily FX purchases for the month of August. We had felt in the past that these were contributing to the krone's underperformance. These had been cut back from NOK1.1mn to NOK1mn between June and July. Given oil prices are doing well and that the trade-weighted krone has rallied 4.5% this month, presumably we should not see these purchases cut much further. But the market might take any increase in the FX purchase as a mild krone negative.

Chris Turner

CEE: Polish inflation one step closer to single-digit territory

After two light weeks and a strong global story, attention returns to the region. Today sees the release of July inflation in Poland and 2Q GDP numbers in the Czech Republic. In Poland, we expect inflation to have fallen again from 11.5% to 10.9% year-on-year, slightly below market expectations. As we move closer to single-digit territory, which may warrant the first rate cut, we think the market will be watching closely to see if we get below 11% today. GDP in the Czech Republic is the first 2Q number in the region and monthly indicators point to a stagnant economy or only modest growth. Tomorrow, PMI numbers will be released across the region and the decline in Germany and the eurozone indicates a drop in sentiment in the region as well. Later tomorrow, budget numbers will be released in the Czech Republic. On Thursday, the Czech National Bank (CNB) will meet. Rates are expected to remain unchanged and the main focus will be on the new forecast and the board's view on the first rate cut and the weak CZK. Then on Friday, industry and retail sales data in Hungary and the Czech Republic for June will be released.

The FX market is dominated by the US dollar, which drove CEE FX to weaker levels last week. It is hard to see new positive momentum in the region stemming from the dollar this week, but a stable EUR/USD would at least be positive news. However, other factors are still playing in CEE's favour. Market sentiment remains positive after the Fed and ECB signalled they are nearing the end of their hiking cycles. Gas prices, key for the forint and the koruna, hit their lowest level in two weeks on Friday after spiking earlier. Locally, rates rebounded and interest rate differentials improved visibly in the Czech Republic and Poland. The Polish zloty hit its strongest levels since September 2020 late last week and today's inflation could determine the direction going forward. The zloty remains the most long currency in the region in our view, however, the best current account picture in CEE and MinFin transactions in the market should prevent any sell-off. Therefore, we see more of a further slide in EUR/PLN to the downside. The Czech koruna returned below 24.00 EUR/CZK on Friday and of course, the Czech National Bank will be a major player this week. We expect hawkish words of support given that FX is an important pillar of monetary policy these days. Therefore, we could see further recovery towards 23.90 EUR/CZK.

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