

FX Daily: Curb your enthusiasm

EUR/USD briefly bounced back to the 1.0200 mark yesterday and is currently trading slightly below this level, benefiting from some weak dollar momentum – which we don't expect to last long – and maybe also from a sanguine approach to the Italian government crisis. With headwinds to the eurozone outlook remaining high, downside risk for EUR/USD persists



➔ USD: Keeping an eye on housing data

The dollar started the week on the back foot yesterday, as the FX market appeared to trade largely on a risk-on narrative. Contributing to the softer dollar environment has been the repricing lower in the Fed's rate expectations, with the prospect of a 100bp rate hike in July now almost fully priced out (80bp is expected, according to the OIS market). While we doubt that the market will find any reason to realistically reconsider a 100bp move before next week's FOMC meeting, we continue to see a 75bp move as enough to put a floor under the dollar in the near term.

The US calendar is set to keep playing a secondary role this week, although the housing story has been a rather central theme lately, and markets will keep a close eye on June's housing starts. The rise in mortgage rates likely added some pressure to the sector, which is a rather relevant one as it

is correlated with retail sales. A significantly bigger-than-expected drop might push markets to reconsider their bets for aggressive tightening by the Fed, even though the pricing for the July meeting may not be impacted.

We expect some consolidation in the dollar around current levels this week. Another round of risk-on trading in FX is surely possible and could trigger another small dollar correction, but the overall environment (and the proximity to the July FOMC hike) seems unlikely to warrant a more sustained dollar contraction.

➔ EUR: Break above 1.0200 less likely than another correction

EUR/USD touched 1.0200 for the first time in nearly two weeks yesterday and currently is trading slightly below this level, but we see the resistance partly as a testament to how the still-challenging environment in the eurozone is keeping any bullish sentiment on EUR capped. We continue to believe that another drop to parity is possible over the coming days.

One factor that may well have contributed to lifting the euro yesterday was the market's rather sanguine approach (as shown by the BTP-Bund spread) to the Italian government crisis. It appears that some 5-star Movement MPs are now considering the idea of giving back support to PM Mario Draghi, and there have been numerous calls from across the country to keep the national unity government in place. However, right-wing parties (who are projected to gather the most votes in an election, according to the latest polls) have been calling for an early vote. Tomorrow will be a key date as Draghi will announce his resignation before parliament and will discuss potential options with the President of the Republic. At this stage, it's hard to see where this could go. Arguably, all [our four scenarios for Italian politics](#) remain possible, and downside risks for the euro (especially against the Swiss franc) remain elevated as the risk of snap elections has increased.

The gas supply story also remains highly in focus and bears the risk of triggering a significantly bigger drop in the euro. The European Commission estimated yesterday that a cut-off of Russia's gas supply would trim 1.5% off the EU's GDP. It's likely that we'll hear more developments on that over the coming days.

For now, EUR/USD seems to be trading mostly in line with the dollar, although the threats highlighted above suggest a downward-skewed balance of risks.

➔ GBP: UK jobs data does not change BoE story

The [latest UK jobs data](#) is unlikely to change too many minds within the Bank of England's policy committee. Those that have been pushing for 50bp rate hikes will remain concerned about worker shortages and the impact on wage growth, while the doves will focus on some fresh signs that the jobs market is no longer tightening. Still, given that markets are fully pricing in a 50bp hike and that the MPC is concerned about recent sterling pressure, we narrowly think the BoE will implement a 50bp hike at its August meeting.

The Tory leadership race remains open. None of the candidates received 120 votes to secure a place in the final two, however, Rishi Sunak is the closest with 115 votes. But the debate is reaching a stalemate and the sudden decision may not deliver the result that the Tories would have wanted.

We still estimate that the pound will remain, by and large, untouched by political developments

over the coming days, while data should have a larger impact. If markets see more reasons to fully price in a 50bp rate hike in August, we could see some benefit for the pound, but GBP/USD is set to remain mostly driven by external factors and dollar dynamics.

📌 PLN: A stronger euro saved the zloty from a dovish sell-off

Yesterday's EUR/USD move shuffled the cards in Central and Eastern Europe and provided a counterweight to falling market rates. This means welcome support mainly for the Polish zloty, which was hit yesterday by central bank governor Adam Glapinski's statement that if interest rates are to be raised at all, it will only be by 25bp. Although the circumstances of the interview raise doubts about the seriousness of the statement, the short end of the curve fell 20-35bp. Thus, in conjunction with rising core rates, the rate differential has returned to levels seen at the start of last week. However, a higher EUR/USD could hold the recent zloty gains, and we could remain slightly below 4.80 EUR/PLN. Overall, however, market expectations have taken a few dovish hits recently, which is not helped by low market liquidity. Nevertheless, we continue to believe that the situation is not as dovish as the market is currently interpreting it, though we are unlikely to see much reason to change anything for the days ahead. At the end of next week, however, inflation for July will be released, which could revive the hawkish tone again, return market expectations upwards and find new support for the Polish zloty. Until then, the zloty can be expected to remain in the hands of the global events.

Author

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central

Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.