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FX

FX Daily: Data sensitivity to keep FX volatility high

Data releases should keep generating above-average volatility in the FX market now that major central banks are switching to a fully-fledged data dependency. Today, CPI and GDP figures out of the eurozone will be the main highlights. We don't see significant dollar implications from the US having fallen into a technical recession for now



We would not put ourselves in the 'peak dollar' camp

➔ USD: Not much more room for dovish repricing

The volatile market reaction to yesterday's [poor GDP figures](#) out of the US offered an idea of what we should expect for the coming weeks: an elevated sensitivity of rate expectations and the dollar to incoming data points. In our view, this means that dollar-crosses volatility is unlikely to abate in the near term.

Looking at the effective implications of the US falling into a technical recession, we don't see it going much beyond the 10bp that has been approximately priced out of the Fed curve. After all, the Fed reiterated this week that its focus remains on fighting inflation, and a resilient jobs market is continuing to postpone the prospect of a "real" recession. From an FX perspective, we don't see the dollar suffering from much more Fed dovish repricing considering the current

economic backdrop – only 90bp tightening is priced in by year-end – and more weakness might, if anything, derive from a further rebound in global equities, should investors continue to look at the glass half empty (less scope for Fed tightening) of a US slowdown.

Also on this point, we struggle to envision a major recovery in global risk assets just yet, given the still elevated risks on the geopolitical/commodity side, and we also doubt markets will be quick to offload their dollar positions as the world's economic outlook worsens. A winner in this environment could continue to be the Japanese yen, which may benefit from lingering instability in global risk sentiment while enjoying a longer-lasting respite in bonds. At the moment, we think that a substantial short-squeeze is exacerbating the drop in USD/JPY: the next big level is the 130.00 support, which if broken could trigger another sizeable technical drop. It's looking like levels above 135.00 may indeed be past us.

Back to the US, the data releases to watch today are the 2Q employment cost index, June's personal income and the MNI Chicago PMIs. Expect a smaller reaction compared to yesterday, but USD data sensitivity should remain relatively elevated. Our base case for today is, however, for the dollar to stabilise around current levels.

➔ **EUR: A very exciting Friday**

Yesterday's CPI numbers out of Germany sent signals that a smooth decrease in inflation cannot be the base case scenario for now. Today, we'll see the eurozone-wide CPI report, with another acceleration set to support expectations around a 50bp hike by the ECB in September (currently, 45bp is priced in).

We'll also see 2Q GDP figures for the whole euro area today. French figures have already been released and showed that a technical recession was averted (+0.5% quarter-on-quarter). Consensus was centred around a 0.2% QoQ eurozone read this morning.

With the ECB firmly focused on inflation rather than growth, and given the backward-looking nature of GDP releases, the impact on the euro should be larger from CPI readings today – barring major surprises in the growth figures. Volatility may prove rather elevated today too in EUR-crosses, although the USD may prove more stable, and EUR/USD may end the week close to the 1.0200 gravity line.

➔ **GBP: Bank of England pricing still following the Fed's**

Around 9bp of tightening expectations ahead of next week's Bank of England (BoE) meeting has been priced out in the past two days. This is another testament to how a potential 50bp would be largely a function of global monetary tightening trends rather than primarily driven by domestic dynamics.

Our [UK economist discusses in detail here](#) why a 50bp move (still our base case for next week) would likely be a one-off, as well as highlighting key dovish and hawkish risks.

The drop in EUR/GBP has been almost entirely driven by the EUR leg and global risk sentiment (to which the pound is more sensitive than the euro), and given the lack of any major domestic drivers in the UK before the 4 August BoE meeting, this should continue to be the case. Some rebound back above 0.8400 may be on the cards after the big drop and if CPI and GDP numbers out of the eurozone both prove resilient today.

📈 CEE: Coming home after a tough week

Today's calendar offers the July inflation print in Poland, the first estimate of 2Q GDP in the Czech Republic and PPI in Hungary. Most interesting will be the release in Poland, which should give the National Bank of Poland (NBP) ammunition for a dovish U-turn. We expect inflation to fall by one-tenth to 15.4% year-on-year, slightly below market expectations, thanks to fuel discounts. However, we think this is only temporary and we will see inflation pick up again in the coming months.

The Czech Republic will be the first in the region to release its 2Q GDP result, which of course should be the most affected by the Ukrainian conflict. The market expects a -0.4% QoQ drop, which is a significantly better number than the Czech National Bank (CNB) expected in the May forecast (-1.2%). However, the range of estimates is unusually wide, reflecting the uncertainty associated with the effect of the conflict on the Czech economy.

On the FX side, despite the initial hesitation, the Polish zloty managed to get closer to [our target levels yesterday](#), but we believe it still has room to go lower. Of course, the risk is today's inflation release, which, in case of a more significant downside surprise, could erase the market's remaining expectations for further NBP rate hikes and undermine the zloty's path to new gains. The Hungarian forint headed in the opposite direction to our expectations but, like the zloty, it turned around in time and is starting today at similar levels to yesterday. Here as well, we still see room to go lower closer to 400.

The koruna tested the CNB level of 24.60 again yesterday and we can expect this to continue in the coming days. The first available numbers for this week suggest that the central bank has returned to the market after two weeks of silence to prevent the koruna from weakening, however, we expect that only [next week's meeting](#) will properly test the CNB's will to keep the koruna below this level.

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