# FX Daily: Dollar supporters rally

The dollar is enjoying an ideal combination of conditions that support it staying below parity, while the euro will see another PMI drop today, supporting the divergence between the US and Europe. We also see downside risks for sterling, and the sell-off continues in the CEE region

The dollar has remained strong as markets reinforce their hawkish expectations ahead of Jackson Hole, the annual Fed event in Wyoming

## USD: Keeping its strength

The dollar has remained well in demand at the start of this week, enjoying a rather ideal combination of a) markets reinforcing their hawkish expectations ahead of Jackson Hole; b) global risk sentiment instability fuelling defensive trades; and c) further rises in gas prices worsening the outlook for other parts of the world (the eurozone in particular). Today, there is no scheduled Fedspeak and investors will instead monitor August's PMIs across major economies. Some price action in USD-crosses may end up being determined by any divergence in the surveys between the US and Europe, but the broad global macro picture that is currently supporting the dollar seems unlikely to be changed much from data at the moment.

We cannot exclude that some data releases trigger a long-covering effect in the dollar and a correction, but a sustained rebound in most G10 currencies against the greenback seems unlikely to us at this stage. Hawkish expectations heading into Fed Chair Jerome Powell's speech on Friday at Jackson Hole should keep a fairly solid floor under the dollar for now, and probably pro-cyclical currencies (European FX in particular) on the back foot as the global risk environment remains choppy.

We may see 110 in DXY by the end of the week, and even at that level calling the dollar peak would prove risky.

*Francesco Pesole*

## EUR: Time to stabilise below parity?

EUR/USD suffered another sharp drop yesterday, as a breach of parity led to a break below 20-year lows. While the move likely brought the pair further into short-term undervaluation territory, we must reiterate two important points. First, a prolonged short-term undervaluation, so a risk premium, is not unwarranted considering the unprecedented risks to the eurozone's economic outlook caused by seemingly unstoppable energy price increases. Like in previous instances – e.g. the Greek crisis, and Italian political turmoil – that risk premium can remain priced into EUR/USD for several months.

The second point is on medium-term valuation. As recently discussed in this piece, the shock to the eurozone's terms of trade means that a EUR/USD trading moderately below parity is not cheap in real terms when economic fundamentals are taken into account. Another factor to take into account is the potential readjustment of Asian central bank reserves which may include selling EUR/USD after dollar-denominated interventions to support local currencies.

A key question is whether the ECB will start discussing active support to the currency now that we have broken decisively below parity. We'll hear from Fabio Panetta today in a scheduled speech, but keep an eye on any unscheduled remarks by hawkish members that may well become even more vocal on the weak euro. On the data side, today's PMIs will be the main highlight of the week, and our economists expect another drop after July's grim readings, which may leave EUR/USD vulnerable to the 0.9800-0.9850 area.

*Francesco Pesole*

## GBP: Remaining fragile

Rising energy prices should have put pressure on UK PMIs too, and this may keep the pound without any real solid floor against dollar appreciation. Downside risks to GBP/USD remain quite elevated, and a move to the 1.1500 mark (last seen during the March 2020 flash crash) now looks like a tangible possibility.

EUR/GBP should instead keep trading in tighter ranges, as markets see the eurozone's and the UK's economic outlook following similar rocky paths. Oscillations within the 0.8400-0.8500 range may continue to rule in the near term.

*Francesco Pesole*

## CEE: All eyes on the forint

Today's calendar in the region is basically empty and the living conditions for CEE currencies have deteriorated again. Gas prices are once again hitting new highs, core rates are pushing interest rate differentials down across the region – with the exception of Hungary – and EUR/USD has crossed parity and looks set to stay there longer this time than last time. So all indications are that the sell-off in CEE will continue this week.

The Polish zloty hit our target yesterday and we see room for it to go up again to 4.79 EUR/PLN. However, the Hungarian forint will be the biggest focus as it touched the 410 EUR/HUF level yesterday. Rising rates continue to point to stronger levels for the forint, but under current conditions it has become the least popular currency in the region. So the most common question we get these days is whether the National Bank of Hungary will intervene on Thursday by raising the one-week deposit rate. Of course, it depends on the forint levels in the coming days, but unless the forint goes into a freefall closer to 420 EUR/HUF, we believe the NBH will remain calm and disappoint market expectations again this week, which paradoxically may lead to further FX weakness.

For comparison, it is worth looking at the sell-off in early July, when the forint was even above 415 EUR/HUF when the NBH surprisingly raised the one-week deposit rate by 200bp. However, even then the forint weakened again and the calm came only at the end of the sell-off across the region. Thus, if the central bank wants to show its strength, it will have to come up with a bigger bazooka and only at next week's regular monetary policy meeting. Otherwise, it would risk firing bullets without the desired effect. Moreover, by then the situation may be resolved without NBH intervention, which would certainly be the preferred solution.

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