

FX Daily: Dollar to stay supported into the Fed

Fed day has arrived. A 25bp hike is widely expected and it looks far too early for the central bank to soften up its FOMC statement by embracing recent disinflationary trends. This should see the dollar holding onto some of its modest gains made over the last week. Elsewhere, the EM and commodity complex will want to be fed more news on China stimulus



USD: Dollar to hold gains

A look at FX performance over the last five trading sessions provides a good insight into the market's mindset and echoes the themes we highlighted yesterday of European pessimism and Chinese optimism. In the G10 space, the dollar has been the strongest currency but able to withstand that modest dollar strength the best has been the commodity complex of the Australian and Canadian dollars, plus the Norwegian krone. Underperforming has been the euro, with EUR/USD down 1.3% over the week. Indeed, we have seen independent euro weakness on the back of the soft PMI data and European Central Bank (ECB) lending survey.

In the EM space, a similar story is playing out. Outperforming is the renminbi and its two most correlated currencies in the EM space, the South African rand and the Brazilian real. Underperforming on the back of the weak European story are the Hungarian forint and the Czech koruna. Also underperforming is the Chilean peso, where the central bank has recently

announced a programme to replenish sorely depleted FX reserves.

Important drivers of the FX story near term will therefore be whether the Federal Reserve stays hawkish, whether the ECB stays hawkish in the face of softening data and whether Chinese authorities follow through with detailed and sufficiently powerful stimulus to see the commodity currencies hold onto recent gains. Regarding the Fed, we think it is [too early to remove key language from its statement that further tightening may be appropriate](#) after today's 25bp hike. And we wonder whether it wants to push back against the 100bp of easing priced in for 2024. We see the Fed event risk as a mildly positive one for the dollar.

DXY to trade 101.00-101.50 into the Fed, with risks of a breakout to 102.00 today.

Chris Turner

➔ EUR: Soggy

The ECB's euro trade-weighted index has fallen 1.3% so far this week. That is quite a sharp move. It seems investors have been unnerved by both the [soft July PMI](#) data and the [ECB bank lending survey](#). The latter showed much tighter lending standards and a sharp decline in loans, particularly among businesses. There is not much European data today and instead, it looks as though EUR/USD will continue to trade on the soggy side through the session – especially since some of the China stimulus-powered rally in related asset classes (e.g., China mainland equities) looks to be petering out.

In our [Fed preview](#) published last week, we had targeted EUR/USD at 1.1050 on a slightly hawkish Fed meeting today. Softer European data has already brought us to that level. That suggests risk in EUR/USD towards 1.1000 on the back of the Fed at 20CET today – assuming the FX options market is correctly pricing a 60 pip range for EUR/USD over the next 24 hours.

Elsewhere, the softer euro has seen EUR/CHF dip to 0.9550. Swiss National Bank (SNB) sight deposit data released on Monday suggested the SNB was still selling FX reserves last week to get the trade-weighted Swiss franc stronger to fight inflation. The SNB does seem to like complete control over this currency pair and while the direction of travel may be 0.9500 or even last September's low near 0.9415, expect the moves to be very gradual.

Chris Turner

➔ GBP: Sterling enjoys the travails of the euro

Having traded as high as 0.87 last week on the back of the softer UK CPI data, EUR/GBP is now back at 0.8570. This is entirely a euro-driven move and does not represent some bullish re-appraisal of sterling's prospects. Indeed, the UK calendar looks very light until the Bank of England (BoE) rate meeting on August 3rd. Here, the market is now pricing 33bp of tightening in the policy rate, down sharply from the 50bp of tightening that was priced in mid-June.

Given that we are mildly negative on the euro going into tomorrow's ECB meeting and that UK rates might be dragged higher by US rates later today, we would say EUR/GBP could have a little more downside to the 0.8520 area over the next couple of sessions.

Chris Turner

➔ HUF: Sticking to the script

Yesterday's meeting of the [National Bank of Hungary](#) did not bring much news. The bank board reassured the markets again that it is in no way planning to increase the pace of rate cuts from the current 100bp per month and that is our view until September when central bank rates should converge to 13%. The first change to the base rate then comes in November, which will start off the series of 100bp cuts according to our forecast. From a market perspective, yesterday's meeting didn't bring much new to our market view.

EUR/HUF was slightly higher intraday after yesterday's press conference, but so far we see that as more of a global story. The US dollar index and gas prices moved slightly higher again yesterday, both negative for HUF. However, in both cases, we see this as a short-term issue and still expect a stronger HUF supported by stable policy direction, high carry and weaker US dollar in the medium-term.

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