

FX Daily: ECB to hike, but don't get too excited for the euro

It's a close call, but we expect a 25bp hike by the ECB today. Markets are pricing in a 65% implied probability of a hike, so EUR/USD should rise after the announcement if we are right. However, a full 25bp are factored in by year-end, and it will be hard for Lagarde to convince markets the ECB can push rates even higher. Any EUR rally may be short-lived



The European Central Bank in Frankfurt, Germany

📉 USD: Muted reaction to CPI, but still good news for the dollar

US inflation came in slightly hotter than expected in the August report released yesterday. As noted by our US economist [here](#), the core print was 0.278%: not a terrible miss to the 0.2% consensus, but probably enough to convince the majority of FOMC members to keep one rate hike in their end-2023 dot plot projections. The headline surprise was, instead, primarily driven by the 10% jump in gasoline prices.

The market reaction was, however, quite muted. We could speculate on some extremely forward-looking interpretation of the data, but we think it was just a case of rates and FX having priced in an above-consensus CPI ahead of the release. Still, the broader dollar story is firmer now heading into next week's Federal Reserve meeting. A hike is unlikely, and dot plots will move the market. If the blip in the disinflation process that emerged in these August figures prevents a big dovish

revision of the 2023 dots, then the evidence of US economic resilience since the last projections (June) means the 2024 dots could be revised higher. It all argues against any near-term turn lower in the greenback; that is, unless US activity data starts to disappoint.

Today, markets will closely watch the European Central Bank, but the US calendar is also quite busy. Along with the jobless claims – which dropped much more than expected last week – retail sales, PPI and Empire Manufacturing figures for August will be released. We see DXY contracting on the back of the ECB hike, but as we discuss below, we don't expect the EUR/USD rally to be long-lived: the dollar index could be trading back around 104.50/105.00 before the Fed meeting.

Francesco Pesole

⬆️ EUR: A post-hike rally may not last

We published two previews of today's ECB policy announcement. Here is [one from our economics teams](#), explaining why we expect a 25bp rate hike; and here is our [ECB cheat sheet](#), where we look at four potential outcomes along with implications for rates and FX.

Since we wrote those previews, markets have grown more confident that the ECB will go ahead with a hike today, especially after Reuters reported that the new staff projections will include an upward revision of 2024 inflation to above 3%. We were not expecting this meeting to be a turning point for EUR/USD. The recent hawkish repricing in EUR rates helped us consolidate this view, and even if we expect a EUR-positive hike today, we admit it is a close call, meaning the balance of risks is asymmetrically skewed to the downside for the euro.

The main reasons why we aren't convinced the ECB can trigger a sustainable EUR/USD rally are current pricing and communication challenges. Markets are pricing in 23bp of tightening by year-end, so the effective beneficial effect of a hike today would depend on how much the statement and President Christine Lagarde's press conference manage to convince markets that the door remains open to more tightening. The risks here are twofold: that the message fails to hide the doves' discontent with a hike; or that the doves manage to dwarf data-dependency. There is also the additional possibility of some dissenter tipping the media after the announcement with some more dovish statement.

We think that the most bullish outcome for the euro, especially in terms of the sustainability of a euro rally beyond the very near term, would require a united front on data dependency and/or openness to an acceleration in quantitative tightening. Otherwise – and this is our base case – we expect a EUR/USD post-meeting jump to stall around 1.0800/1.0830 (if not falling short of those levels), and gradually giving up gains as the dollar's momentum remains solid.

Francesco Pesole

➡️ AUD: Stronger than expected employment gains

The Aussie dollar is trading on the strong side this morning after a stronger-than-expected August jobs report in Australia. Employment rose 64.9k after July's negative reading, and the unemployment rate was unchanged at 3.7%. As explained by our economist [in this note](#), the hiring spike was almost entirely related to part-time jobs. Still, some of those jobs will become full-time in the coming months, which can also push wages higher.

We remain reluctant to pencil out another hike by the Reserve Bank from our forecasts, and still

narrowly favour one last rate increase to 4.35% by year-end. The new Governor, Michele Bullock, may want to convey the message she is serious about bringing inflation down, and if inflationary pressures show some resilience, she could deliver a final hike at one of the three remaining meetings of 2023.

Markets are pricing in a mere 9bp of tightening to the peak, even after the strong jobs figures, meaning there is ample room for a hawkish repricing and AUD to benefit from it. Still, the USD/US activity data story remains much more important for AUD/USD, and we see the pair being capped below 0.6500 for the remainder of September as the USD remains supported post-Fed.

Francesco Pesole

SEK: Faster disinflation poses FX risks ahead of Riksbank meeting

Swedish inflation figures for August showed a faster-than-expected decline this morning. Despite consensus already anticipating CPIF inflation would slow sharply from 6.4% to 4.9%, the August print came in at 4.7%. The core rate (CPIF excluding energy), which is closely watched by the Riksbank, was 7.2%, down from 8.0% in July.

EUR/SEK is not hugely changed after the release, but is feeling some upward pressure again and re-testing the 11.9620 21 August highs. However, the downside risks for the krona of this faster-than-expected disinflation (first negative month-on-month core reading since December 2021) might be greater than what we can observe in the immediate FX reaction. We'll need to wait for the Prospera inflation expectation survey tomorrow, which is a key input for Riksbank's policy decisions, but there is a higher risk that if the Riksbank hikes, some doves may voice their dissent as they did back in April. On that occasion, the implications for SEK were disastrous.

With SEK trading at historical lows, we are more inclined to think Riksbank members will show a united front and preserve currency stability. That would require not just a hike, but also signalling another one in rate projections, as discussed in [our latest note on this topic](#). We are slightly less convinced the Riksbank can convey this hawkish message next week after these inflation figures, but it remains our base case. If the ECB hikes today, risk sentiment remains unfavourable and the Fed is hawkish next week, EUR/SEK may well be hitting 12.00 before the Riksbank meeting: another incentive to be hawkish for Swedish policymakers.

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