

FX Daily: Energy crisis pulls rug from under the big exporting nations

It is a familiar narrative, but a firmly hawkish Fed plus major exporting nations seeing their trade surpluses wiped out by higher energy costs continue to drive the dollar higher. And we doubt an extra 25bp of ECB tightening this autumn makes much of a difference to the soft EUR/USD profile. Look out for PMIs and US manufacturing ISM today. Dollar to stay bid



Over recent weeks and months, we had felt that sterling could hold its own against the weakened euro - but clearly it has failed to do so

USD: Fed curve gets priced higher and flatter

It is fair to say the dollar remains very well bid across the board. The much-followed DXY trade-weighted dollar index remains close to its highs of the year above 109, while other trade-weighted measures more weighted towards emerging markets push even higher. Two key factors remain at work here.

The first is the Fed. Here pricing in US money markets of the Fed policy curve continues to move higher and flatter. By that we mean the terminal rate pricing has now pushed up to 3.95% for next spring, while the easing for late 2023 is also being priced out too. Notably, December 2023 Fed Funds futures now price Fed rates at 3.60%. Back in late July during the 'Fed pivot' story, these

futures had dropped to 2.70%. In short, we have seen quite a re-pricing over the last month – a re-pricing that may not be over yet. Yesterday Fed hawk Esther George spoke of needing to get Fed Funds above 4% and keeping it above there for 2023.

Given the experience over the last month and the very hawkish speech of Fed Chair Jerome Powell last Friday, we doubt that even a modestly softer August jobs report tomorrow will be enough to dent this Fed pricing or the dollar.

The second factor is the energy crisis, which wiped out traditional trade surpluses for the big energy importers in Europe and Asia. Overnight Korea announced a [\\$10bn trade deficit for the month of August](#). In September 2020, Korea was running close to a \$10bn monthly trade surplus. The Bank of Korea's 125bp of tightening has provided little support to the Korean won – which has fallen 12% against the dollar this year. Equally, we think 100-125bp of ECB hikes this year will struggle to provide much support to EUR/USD, which has equally fallen 12% this year.

For today we will see US ISM manufacturing and the initial jobless claims numbers. We doubt these can put too much of a dent in the dollar's rally ahead of tomorrow's US jobs report. DXY to stay bid above 109.00 and could make a run at 110.00 at any time.

Chris Turner

📉 EUR: ECB hawks may struggle to generate euro lift-off

Above-consensus eurozone CPI for August predictably brought out the ECB hawks yesterday, with Austria's Robert Holzmann again suggesting that a 75bp hike be debated at next week's meeting. Markets now price 69bp of hikes at the September meeting, a total of 130bp by the October meeting, and a total of 167bp by year-end. This has contributed to a 1% rally in the ECB's trade-weighted euro over the last few days. However, the recent narrowing in EUR: USD two-year swap spreads may have run its course, and a reversal – should the ECB not deliver on this new hawkish pricing – could send EUR/USD to fresh lows next week.

Data in the region is more detailed on the August PMIs. Overall we see investors in no mood to let go of their precious and high-yielding (2.30% overnight rate) dollars. EUR/USD to stay offered in a 0.9900-1.0100 range.

Chris Turner

📉 GBP: This is getting serious

Over recent weeks and months, we had felt that sterling could hold its own against the weakened euro – but clearly it has failed to do so. The Bank of England's (BoE's) trade-weighted sterling fell more than 3% in August and now sits at a new low for the year. Our premise for sterling staying supported was that foreign owners of Gilts would have to cut FX hedge ratios because of rising sterling hedging costs. That view is, shall we say, challenged by foreign investors dumping Gilts. Foreigners sold £16.5bn of Gilts in July according to BoE data, the largest sale since July 2018.

Our debt strategy team note some worrying developments in the Gilt market – where underperformance of Gilts versus GBP swaps suggests some independent concerns mounting over Gilts, be it quantitative tightening plans from the BoE or perhaps even some fears over what Britain's next prime minister plans to do with the nation's balance sheet. Notably, the UK's 5-year sovereign Credit Default Swap is starting to rise too.

A fiscal risk premium looks to be going into GBP. Cable retesting the March 2020 flash-crash low of 1.1415 looks the path of least resistance. And 0.8720 is the bias for EUR/GBP.

Chris Turner

📉 CEE: Too much, too soon

Today we have PMI prints for the CEE region in the calendar. Recent months have shown a significant drop in sentiment, especially in Poland, and we cannot expect a significant reversal of the trend for August either. On the other hand, the recent German release suggests at least a halt to the decline in sentiment in the region. Today, we will also see the detail of GDP in Hungary which surprised positively in 2Q. The National Bank of Hungary (NBH) will decide on the one-week deposit rate, however, we cannot expect anything other than a 100bp hike – similar to when the central bank on Tuesday raised the base rate. Later today, the Czech Republic's state budget result will be released, where pressures to loosen fiscal policy are growing.

On the FX side, conditions in the region have improved significantly in recent days. EUR/USD above parity has eased pressure on EM markets, gas prices have dropped, and market expectations of rate hikes have increased a bit in the region for the first time in a while. The result is stronger currencies across the region, however, perhaps this is too much, too soon. Thus, we see the region at the moment as highly vulnerable to incoming negative news, which may be the PMI print today. But overall, nothing has changed in the CEE story in recent days. The tougher part of the year is yet to come in terms of both the gas story and negative economic numbers, and on top of that FX is losing the support of hawkish central banks and rising interest rate differentials. So despite recent gains, we remain bearish on CEE currencies over the coming days.

Frantisek Taborsky

Authors

Chris Turner

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

chris.turner@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@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 <http://www.ing.com>.