FX Daily: Hawkish Fed minutes raise the bar for data disappointment

Yesterday's release of the June FOMC minutes gave very few reasons to doubt the Fed's determination to keep raising rates. In a way, the bar for data disappointment and consequent dovish repricing may now be higher. Still, expect a hit to the dollar if the ISM services fall into contractionary territory. Job openings and ADP payrolls will also be watched

USD: Growth and jobs under the microscope

The narrative that emerged from the minutes of the June FOMC meeting fell unequivocally on the hawkish side of the spectrum. The summary of opinions confirmed some divergence within the committee, as some members would have favoured a hike already in June, but accepted a pause and signalled instead more tightening via the new dot plot projections. "Almost all" participants thought more tightening was likely this year.

There was also an acknowledgement of ongoing firm GDP growth and high inflation, with core inflation, in particular, showing no tendency to ease as of yet this year. The Fed also noted that credit remains available to high-rated borrowers, but that lending conditions had tightened further for bank-dependent borrowers. Still, the risk of a credit crunch was deemed modest.

All in all, the minutes offered no reason to doubt the Fed will go ahead with a July hike (85% priced in) unless data points firmly in the opposite direction on the economic and inflation side. The hawkish minutes, however, may have further raised the bar for disappointing data to cast doubt on further tightening.

Today, the ISM services figures for June will be closely watched, as last month's print (50.3) surprised sharply on the downside. Consensus is expecting a rebound to 51.2, while another surprise drop could take the index into contractionary territory – where the ISM manufacturing has been for the past eight months. Expect any surprises on the ISM release to drive most of the dollar reaction today, but markets will also look at some labour data, in particular, the JOLTS job opening figures for May and the ADP payrolls for June.

The dollar has drawn some strength from the hawkish FOMC minutes, which have so clearly pointed to more tightening, that it will probably take some substantial downside surprise for markets re-consider their expectations. With this in mind, the dollar's reaction to today's data may not prove particularly long-lived, especially if tomorrow's payrolls continue to point to a tight jobs market and keep a post-July hike on the table.

Francesco Pesole

EUR: Downside risks into the weekend

Medium-term consumer inflation expectations in the eurozone continued to ease in May, with the 12-month expectation gauge declining from 4.1% to 3.9%. However, long-term (three-year) inflation expectations – arguably of greater interest for the European Central Bank - remained unchanged at 2.5%, well above the bank's 2% target. When taking June's flash core CPI estimates on board, the ECB hawks hardly lack arguments to continue tightening.

Today, the eurozone calendar is very light, and EUR/USD will trade in line with the dollar's reaction to US data. We suspect the pair is facing some downside risks in the latter part of the year after the FOMC minutes set the bar quite high for data to convince markets to price out Fed rate hikes. There is still a gap to be filled (around 20bp) between the Fed communication (dot plots) and the market pricing, while the ECB's communication is pretty much matched by the EUR OIS curve, which currently embeds two hikes by year-end. EUR/USD could slip below 1.0800 before the end of the week, if US data were to come in on the strong side.

Francesco Pesole

GBP: Watch for data outliers

Today's focus will be on the Bank of England's Decision Maker survey, which has pointed to easing pay and price expectations over the coming months. Hard data has pointed in the opposite direction, and this might emerge again as an outlier in a very "hawkish" set of data for the BoE and markets today.

Markets remain highly sensitive to any incoming developments on the price side and the still quite aggressive BoE tightening expectations (140bp by January 2024) do point to some risk of recalibration (and GBP downside risks) around any release.

EUR/GBP has been weakening in the past two sessions, but may find some support around current levels and even converge back to 0.8600 as the overbought pound faces some BoE repricing threat.

Francesco Pesole

CEE: Dovish NBP should not push zloty to weaker levels

Apart from the morning data from Romania and Hungary, the main event on the calendar in the CEE region is the meeting of the National Bank of Poland. After noon we should see the central bank's decision, statement and the basic framework of the new NBP forecast. Governor Adam Glapinski's press conference is scheduled for Friday. In line with the market, we expect rates to remain unchanged and the main focus will be on the new forecast and tomorrow's press conference, in our view. Both can be expected to be dovish in tone. The market has moved significantly in that direction over the past two weeks and is pricing in roughly 100bp of rate cuts by year-end at this point. Thus, the news from the NBP should not come as a surprise to the market though pressure to price in even more rate cuts could be expected.

The Polish zloty joined the sell-off across the region yesterday amid a combination of deteriorating sentiment in Europe, a lower EUR/USD and heavy long positioning in CEE FX especially in the zloty and forint, which lost significantly more than the Czech koruna yesterday. Thus, in the case of PLN, despite the dovish NBP, we should not see much pressure for further weakness today but rather some stabilisation around 4.460 EUR/PLN.

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