

FX Daily: Market finally prices 4% Fed Funds for next spring

It has taken some time, but money markets now price the Fed policy rate at 4% for next spring. A speech by the Fed's Christopher Waller on Friday re-iterated that a 4% Fed funds rate would be seen later this year even as inflation slowed. A high bar for the Fed to pivot and Europe continuing to struggle with the energy crisis should keep the dollar bid on dips



We would not put ourselves in the 'peak dollar' camp

➔ USD: Expect consolidation ahead of tomorrow's August CPI print

The dollar is consolidating after entering another mini-corrective period late last week. Driving Friday's dollar sell-off was probably a combination of views that major trading partners (the eurozone and Japan) were entering a new phase in supporting their currencies - be it more aggressive rate hikes (eurozone) or FX intervention (Japan). The dollar correction has been worth just over 1% and again we would not put ourselves in the 'peak dollar' camp.

For one thing, Fed hiking expectations are still looking for the right level. On Friday, the US money market strip priced the Fed funds rate at 4% for the first time in this cycle. On Friday the Fed's

Christopher Waller gave a [speech](#) highlighting that 4% would be the right Fed level for the turn of the year - and this assumed that inflation would be slowing. He recalled the Fed's quarterly economic projections which assumed that core PCE would have fallen to 4.3% year-on-year by the end of the year. Core PCE currently stands at 4.6% YoY having peaked at 5.3%. The point here is that Waller felt that 4% would be appropriate if inflation slowed to 4.3% - if not the Fed funds rate should be taken into even more restrictive territory.

On that subject, the US data highlight of the week is tomorrow's release of August CPI. While lower gasoline prices should bring headline CPI lower, [core inflation should still be rising](#). And with the Fed expected to hike another 75bp next week and introduce new quarterly projections, we doubt much momentum will build behind a dollar correction.

108.50 may well be enough of a correction for DXY and we would be favouring a move back above 110 next week.

Chris Turner

➔ EUR: And 2% seems to be the target for the ECB

Following Thursday's [hawkish European Central Bank \(ECB\) meeting](#), Friday saw an array of off and on-the-record comments from the ECB. Most seem to point to the need for the ECB policy rate (still seen as the deposit rate) to be taken to the 2.00% area - that is 125bp higher than its new target. Money markets price the deposit rate at 1.75% for year-end and perhaps closer to 2.50% next spring - suggesting the 2% pricing could move forward to year-end should expectations solidify that the ECB hikes 75bp at its 27 October meeting.

The hawkish ECB has seen EUR/USD push up to the 1.0100 area. 1.0150 looks like the top of a bearish channel that has contained the EUR/USD decline since February. That will be the trigger point for a further short squeeze in EUR/USD - though we think it may well hold. Beyond the ECB there is much focus on what European politicians can do to address the energy crisis. EU energy ministers were split on some issues on Friday given national interests. EU Commission President Ursula von der Leyen will, on Wednesday, deliver what has been agreed upon so far - though we suspect it will not be enough to allay fears of a European recession this winter.

Expect EUR/USD to consolidate into tomorrow's US CPI, with again 1.0150 proving the key intra-day resistance level.

Chris Turner

➔ GBP: July GDP slightly softer than expected

July UK GDP has come in slightly softer than expected at 0.2% month-on-month. However, the adjustment for the June bank holiday makes the figures a little difficult to read and we think the Bank of England (BoE) will take more notice of tomorrow's August jobs data for insight into how tight the UK labour market really is. All in, we expect the BoE to hike 50bp again when it decides policy rates on 22 September.

We are not particularly bearish on the dollar - thus we doubt GBP/USD makes it as far as the 1.1730/50 resistance area. EUR/GBP can consolidate in a 0.8650-08720 range after recent gains.

Chris Turner

📌 CEE: Hungary story reaches its conclusion

Inflation in the Czech Republic will be published today. We [expect](#) the year-on-year rate to be unchanged thanks to a strong decline in fuel prices. However, it is still unclear how the statistics office is approaching the sharp increases in energy prices and so a significant upside surprise cannot be ruled out. Tomorrow, we will see current account data for the Czech Republic, Poland and Romania. Industrial production in Romania will be published on Wednesday. On Thursday and Friday, we have secondary inflation numbers in Poland and the Czech Republic.

Beyond that, this week we could hear the first statements from CNB board members ahead of the September meeting and, more interestingly, we could also see some progress in the debates between the Hungarian government and the European Commission over access to EU money. On Wednesday, this topic will be discussed in the European Parliament, which could bring some negative noise, but the final decision should be published by the European Commission next week on Thursday and we expect a positive outcome.

In the FX market, the main theme was the gas price last week, which is now the main driver. Although the interest rate differential is lower across the region, the drop in gas prices late last week indicates further gains for CEE FX, especially for the Polish zloty and Czech koruna. Of course, the CPI print will be key for the koruna, which could potentially reignite hopes for an additional rate hike, but we believe the CNB pain threshold is high enough and even the potential upside surprise will not change the situation. In Hungary, on the other hand, we believe that a positive tone from the European Commission should help the forint settle below the 400 EUR/HUF level.

Frantisek Taborsky

Author

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 www.ing.com.