

FX Daily: Market reads China rate cut as bearish

The week starts with focus on China's 10bp cut in its one-year Medium-Term Lending Facility (MLF). Rather than rallying on the prospect of stimulus, commodity currencies have softened on the view that China may not be the engine of world growth for some time. This comes as US activity strengthens into 3Q22 and should keep the dollar supported



USD: Some economic divergence re-emerges

The highlight as we start the week in Europe is the People's Bank of China's (PBoC's) decision to surprise with a 10bp cut to its MLF rate. This was last cut at the turn of the year and the move follows a weak batch of July Chinese data in the form of aggregate financing, industrial production and retail sales. Occasionally, one might see the commodity currencies rally on news of fresh monetary stimulus. In this instance, however, the Australian dollar is off around 0.5%. This can be rationalised through the view that the Chinese economy is still struggling and looks unlikely to contribute to any upside surprises to global growth this year.

At the same time, investors are wary of new Covid outbreaks amid China's zero-Covid strategy and

the potential for the type of renewed lockdowns that triggered China's GDP contraction in 2Q22. The renminbi has softened on the news and with the PBoC clearly acknowledging the need for more stimulus, investors may start to speculate that the 6.80 ceiling in USD/CNY may not be as strong as it seems. Keep track of USD/CNH here, where any moves through 6.80 could provide some support to the dollar across the board - just as it did back in April this year.

This all comes at a time when US recession fears are ebbing slightly. These views have been supported by Friday's release of [improving US consumer sentiment](#) and this week should be helped by [better industrial production and retail sales numbers](#). The combination of some renewed confidence in US growth set against challenged external growth should calm some of those questioning whether the dollar has peaked. We think the dollar does not start to turn lower until 1Q23.

The US data calendar is light today and most of this week really. Wednesday's release of the July FOMC minutes may cause a flutter, but these minutes are unlikely to mark the final word on whether the Federal Reserve hikes by 50bp or 75bp at its 21 September FOMC meeting.

DXY should stay supported now and a break of 106.00 should open up 106.50.

Chris Turner

⬇ EUR: Sluggish

EUR/USD was understandably hit on Friday's better US consumer sentiment data. Unlike the US consumer being buoyed by the fall in gasoline prices, the bigger focus in Europe is the ongoing rise in gas prices and what it will mean for bills this winter. Negative sentiment is being compounded by drought conditions across much of Europe and the low levels of the Rhine - disrupting raw material transport networks and pushing up costs on other routes. As we mentioned last week, the eurozone's terms of trade index is back at its low for the year and is a euro negative.

In Europe this week we will see German ZEW investor expectations (Tuesday) and the first look at eurozone 2Q22 GDP data (Wednesday). Neither should provide much lasting support for EUR/USD, which can sink back into the 1.0150/0200 area.

Elsewhere this week we have a Norges Bank rate meeting on Thursday where like the Fed, the debate is [whether the next hike is 50bp or 75bp](#). Expect EUR/NOK to remain offered near 9.80 for most of the week.

Chris Turner

➡ GBP: Jobs and CPI dominate this week

The Bank of England (BoE) this week receives two important inputs ahead of its next MPC meeting on 15 September. These are the June jobs data tomorrow and the July CPI on Wednesday. Despite some risk of tightness in the jobs market starting to ease, we doubt the data will be enough to shake off market pricing that another 50bp is on the table for September. For reference, money markets price 40bp of tightening in September.

That should mean EUR/GBP is able to hold below Friday's highs near 0.8485/90. Cable, however, looks vulnerable to dollar strength and could quite easily make a return visit to 1.2000.

Chris Turner

📌 CEE: GDP data will show the true strength of the region

The second half of the month is traditionally lighter for economic data in the Central and Eastern Europe region, but we still have GDP data on the list, which will get more attention than usual this time. The Czech Republic positively surprised two weeks ago with 0.2% quarter-on-quarter growth and narrowly avoided a downturn. [This week](#), we see the biggest risk in Poland, where we expect a 1.2% decline, worse than the market expects. For Hungary and Romania, we expect 0.4% growth, which is more or less in line with expectations, but in all cases the surveys are quite broad, reflecting the uncertainty associated with 2Q. The result will thus set the market's perception of the region for the coming weeks, showing resilience or readiness for a complicated winter. On Friday, in Poland, we will see labour market data, closely watched by the central bank, and PPI data.

The end of last week brought a correction of EUR gains, and CEE currencies did not have much time to react. So, we expect the region to start the week on the back foot. With EUR/USD being the main reason for the current strong levels in CEE currencies, we think this will be the main driver into Wednesday's GDP data release across the region. On the floating side of CEE, we see room for depreciation in the Polish zloty towards EUR/PLN 4,700 given the quick gains in recent days, alongside further declines in the rate differential and a dovish National Bank of Poland. The Hungarian forint looks well positioned and we see only a minor move up to 395 EUR/HUF - though we will have to see how the forint copes with S&P's rating decision on Friday to move the sovereign to a negative outlook.

The Czech koruna is still recovering from the end of the hiking cycle and so far, the market is looking in vain for new candidates to clash with the central bank. However, we believe this is only temporary and the koruna will soon return closer to the Czech National Bank's intervention levels around 24.60-70 EUR/CZK. The Romanian leu is maintaining stronger levels despite our expectations. In our view, the negative fundamentals have been overshadowed by the massive interest in ROMGBs and the associated inflows, however, as with the koruna, we believe this is a temporary stall, though one that may last longer than we initially expected.

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