

FX Daily: Outlining the paths for EUR/USD

Yesterday's PMIs triggered a "sell Europe" dynamic, and demonstrated how growth differentials are becoming an increasingly important driver for the FX market. Such differentials are one of the inputs of [our EUR/USD scenario analysis for 2022-23](#), where we outline different paths ranging from 0.85 to 1.30. Today, central bank speakers will be in focus



📈 USD: Fed rhetoric remains hawkish

The release of June's PMIs yesterday generated some diverging dynamics in the G10 space. A widespread increase in recession fears continues to fuel a recovery in the bond market and by extension in the safe-haven yen, while pro-cyclical European currencies trended lower on the back of grim surveys out of the eurozone. PMIs dropped significantly also in the US, but the dollar is not usually highly sensitive to the release and a generalised "sell Europe" market attitude triggered some defensive inflows into the dollar.

Incidentally, we continued to hear a rather hawkish tone from Fed speakers. Michelle Bowman fully backed a 75bp increase in July and suggested multiple 50bp increases should be delivered after that one. Fed Chair Jerome Powell toned down the recession discussion, sounding more upbeat on the economic outlook yesterday compared to Wednesday's Senate testimony. Today, the

Fedspeak calendar includes James Bullard's speech on central banks and inflation and an interview with Mary Daly. Signs of building consensus around a 75bp rate hike within the FOMC should help consolidate the market's expectations for a Fed rate around 3.25%-3.50% at the turn of the year.

All this should continue to provide a rather supportive undercurrent to the dollar, and we see limited downside risks for the greenback over the near term.

↓ EUR: Growth factor becomes more relevant

A larger drop than expected in [eurozone's PMIs](#) yesterday triggered a quintessential flight-to-safety in European assets, as eurozone equities underperformed their US counterparts, bond yields dropped sharply and both the euro and the Scandies came under pressure. A set of decent PMIs before the June reading had allowed markets to maintain a relatively complacent approach to the eurozone growth story. Now, some re-alignment with the reality of a quite clouded economic outlook and persistent external woes has begun, and we cannot exclude that this continues to add some pressure today, where all the focus will be on another important survey – the German Ifo.

Without doubt, the US-EZ growth differential story is becoming increasingly relevant for EUR/USD. [In the scenario analysis we released yesterday](#), we identify this differential as one of the four major drivers of EUR/USD for the next 18 months, along with developments in the Russia-Ukraine conflict, China's economic outlook, and the ECB-Fed policy outlook. We think that assumptions on these drivers can help outline different scenario paths for EUR/USD that vary between the bottom (0.85) to the top (1.30) of the FX option-derived range for the pair at the end of 2023.

Our baseline scenario remains unchanged for now: EUR/USD to oscillate around the 1.05 mark until the end of 3Q22 as the Fed presses on with aggressive tightening, rising modestly to the 1.08 area in 4Q22 as US rates peak, staying on a moderate upward path in 2023 as the Fed turns from tightening to easing, and the EZ exits stagflation early in the year, finally reaching the 1.15 area by year-end. More details about the different scenarios and our calculation methods are included in the article.

Back to today's price actions, we suspect that the balance of risks remains skewed to the downside for EUR/USD on the back of deteriorating eurozone growth sentiment, and the pair may re-test the 1.0500 level before markets close for the weekend. Also, keep an eye on some relatively dovish ECB speakers: Mario Centeno, Pablo Hernandez de Cos and Luis de Guindos.

→ GBP: A couple of BoE speakers to watch

The UK June PMIs surprised on the upside staying flat compared to a month before, with the release gaining more importance given the sharp contrast with the eurozone and US figures. That is surely not enough to trigger a sizeable re-pricing higher in the UK's growth expectations (retail sales this morning sent fresh warning signals), but may at least allow markets to feel more at ease with their aggressive Bank of England tightening expectations (seven hikes priced in by year-end), offering some support to GBP.

All eyes today will be on speeches by the BoE Chief Economist Huw Pill, and from Jonathan Haskel, one of the three MPC members who voted for a 50bp hike last week. GBP/USD may stay in the 1.22-1.23 range for now, while EUR/GBP may keep inching lower towards the lower half of the 0.8500-0.8600 range.

➔ NOK: No benefits just yet from hawkish Norges Bank

In line with our call, Norges Bank hiked by 50bp yesterday, and upgraded its rate path projections to include a 3.0% terminal rate by mid-2023. As discussed in [our Norges Bank review](#), we are not particularly doubting the bank's guidance for a 25bp move at the August meeting, but a weak currency and elevated commodity prices mean that another 50bp increase in September shouldn't be ruled out.

The reaction in EUR/NOK appeared rather counterintuitive given the hawkish surprise delivered by Norges Bank, with the pair quickly jumping back to 10.50 after a brief and very contained drop. We doubt this signals that the 50bp move was largely priced in (we had no evidence of that in the rates market) but instead that the challenging risk environment continues to keep investors quite structurally bearish on the krone.

We believe that we'll need to witness some material stabilisation in global sentiment for NOK to re-connect with its very attractive set of fundamentals. This may only happen later this year, and we continue to see chances of EUR/NOK trading below 10.00 before year-end.

Authors

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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

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