

## FX Daily: Powell fails to revamp FX volatility

Carry trades may continue to recover this week as FX volatility remains depressed after an uneventful Senate testimony by Fed Chair Powell. He heads to the House today, but it looks likely that the dollar may stabilise further into tomorrow's US CPI. In New Zealand, the RBNZ surprised with a dovish tilt – but we suspect its inflation optimism is overdone



### ➔ USD: CPI needed to shake up FX market

Global currency volatility has continued to drop rapidly as markets await developments on eurozone and US politics, as well as on the data side. The proximity to tomorrow's pivotal CPI release in the US may also be behind this week's cautious trading in FX.

Today, Federal Reserve Chair Jerome Powell faces House policymakers for his second testimony, after yesterday's Senate appearance had few repercussions on markets. As our US economist discusses [here](#), Powell's prepared remarks focused on two-way risks, reiterating the need for more data input to justify monetary easing. So, more of the same rhetoric, and we believe Powell is happy with keeping markets relatively quiet at this stage as some data starts to go in the right

direction. We did read a still modestly dovish bias in Powell's testimony, as he kept adding emphasis on the risks of unduly weakening activity and employment – but the strict data dependency and a swap market that has already priced in 19bp for September was reasonably unimpressed.

Aside from any more Powell headlines, there are no other major macro events in the US today. The US Democratic Party revolt against President Joe Biden appears to have been fully sidelined by markets. Predict index of Biden's probability of being the party's candidate in November has bounced back from 40% to 60% after recent signs that the internal push to replace him may indeed be insufficient.

We expect FX volatility to remain low today, a development that can favour an additional short-term recovery in high carry currencies like MXN and BRL, while keeping the pressure high on the funding yen. The dollar may remain broadly flat into tomorrow's CPI.

*Francesco Pesole*

## ➔ EUR: French coalition talks will be long and tricky

It has become increasingly clear that coalition talks in France will prove a lengthy and complicated process. At this early stage, party leaders within the left-wing New Popular Front are discussing who to propose as prime minister to President Emmanuel Macron – who can, however, reject the candidate. The possibility of a technocrat prime minister would then become more likely as Macron would seek to lure the more moderate fringes of the NFP into a coalition.

Markets would probably choose the technocratic solutions over the others, but it may well take weeks to break the gridlock, and we remain concerned about the bond market getting unnerved by such immobility.

For now, EUR/USD is mostly awaiting developments on the US macro side, and appears comfortable to be trading around 1.08. We could see the pair inch higher on some generally supportive news from the US CPI report tomorrow, but we continue to expect selling interest intensify around 1.09+ as French political and fiscal concerns remain unresolved.

*Francesco Pesole*

## ➔ NZD: A surprise dovish tilt by the RBNZ

The Reserve Bank of New Zealand surprised markets with a dovish tilt in communication as it kept rates on hold at 5.50% overnight. We had thought that the lack of hard data for the second quarter would argue for a reiteration of a hawkish stance, but the Bank displayed greater confidence on disinflation in the statement, stating that “restrictive monetary policy has significantly reduced consumer price inflation” and that the Committee expects headline CPI to return to the 1-3% target range in the second half of this year. Incidentally, there were multiple mentions of slowdown in the economy and the labour market.

Our forecasts included one rate cut by the RBNZ in the fourth quarter this year, but we admit today's statement tilts the balance towards at least two (60bp are priced in by year-end). Policymakers must have looked at some convincing evidence of upcoming disinflation to change their messaging today, but we continue to see some substantial upside risks to their non-tradable inflation forecasts. An upside surprise at next week's second quarter CPI report could help reverse

NZD losses, and we remain generally positive on NZD this summer.

*Francesco Pesole*

## 📌 CZK: Last inflation print before the August meeting

June inflation in the Czech Republic will be published this morning. Yesterday's [figure in Hungary](#) showed a rather weak number and we see a similar picture here today. We expect a drop from 2.6% to 2.5% year-on-year, one tenth above market expectations. The Czech National Bank's forecast here shows 2.4%, in line with market expectations. However, we think core inflation could fall from 2.5% to 2.4% with a downward bias, widening the deviation from the central bank's forecast.

This will be the last inflation number before the CNB's August meeting. While the inflation picture looks better again, there are more issues on the table. The main issue here is the EUR/CZK, which after the last decision got above 25.00 and yesterday jumped back to within reach of 25.300, the highest since April. However, the market has once again switched fully into receiving mode in the rates market, undermining the CZK and pricing in basically a full 25bp cut for August and roughly 90bp by year end in total. However, we could hear the first comments from board members in the coming days, and we suspect that they don't see the situation as clearly. We can see a pause as a possibility, although we see 25bp as the baseline scenario.

EUR/CZK has closely followed the interest rate differential in recent weeks, and this was also the case yesterday. This relationship seems to be strong, and if today's number triggers further rate receiving, EUR/CZK will move above 25.300 and the CNB's forecast. Looking ahead though, if our assumption of seeing the CNB board is correct, this could be a wake up call for the market, pricing out some later rate cuts and helping EUR/CZK down.

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