FX Daily: Quiet start to an intense week

The Independence Day holiday in the US means the week should start quietly in markets, but US data will soon attract the market's attention again now that a July Fed rate hike is a consensus view and there is also speculation about a move in September. We think the dollar can find some support this week. In the CEE region, central banks in Romania and Poland meet

USD: Data in focus amid thin holiday volumes

The month of June saw the dollar weaken against all G10 currencies except for the Japanese yen, but the greenback has been quite supported in the past few days. Some hawkish comments by Federal Reserve Chair Jay Powell at the Sintra central bank symposium last week have helped markets to close the gap with the FOMC's dot plot projections: the Fed funds futures curve currently prices in 34bp of tightening to the peak, a 10bp increase compared to a week ago. Crucially, markets are now actively considering the option of two rate hikes.

This week should start quite quietly with the Independence Day holiday meaning US markets should have reduced flows until tomorrow. Still, US data activity will peak as markets assess the probability of a September hike now that a July increase appears to be the consensus view.

Today, all eyes will be on the ISM manufacturing index, although a greater focus will be on the services survey released on Thursday (the May print dropped more than expected). On Friday, jobs figures for the month of June will be published: after the latest comments by Powell, it will probably take a very weak reading to put a July hike under discussion.

On the Fed side, the first event to note is on Wednesday, when the June FOMC minutes are released. The dollar can probably find some more support this week as markets see more reasons in the data and the minutes to gradually align with the more hawkish dot plot projections.

Francesco Pesole

EUR: Core inflation issues continue for the ECB

The decrease in headline inflation in June was likely insufficient for the European Central Bank given the tick-up in core prices (from 5.3% to 5.4% for the whole euro area). With President Christine Lagarde having pre-committed to a July hike, the discussion is currently around a move in September. Markets are fully pricing in two final hikes, but not by September. Either way, the stickiness in core inflation will give the ECB hawks a chance to reinforce their message.

With ECB members having had the opportunity to clarify their rhetoric at the Sintra symposium last week, this week's speakers may not have a very strong impact on the euro, even though markets will be interested in comments following the inflation report for June.

It seems likely that the USD leg will drive most of the EUR/USD moves this week, especially once US data starts to come in. There is some room for the pair to decline modestly on the back of some dollar strength, although a big drop below 1.0800 may be premature.

Francesco Pesole

GBP: Pricing remains volatile

Pricing for Bank of England tightening remains quite volatile. Markets are pricing in 130bp of BoE hikes to the peak at the moment, which clearly sets the bar quite hike for hawkish surprises for the MPC's communication, but also shows how hawkish-prone markets are given the UK inflation situation.

This week will offer little input from the data side in the UK, and the list of BoE speakers is also quite short. Cable may be primarily driven by the dollar leg, and faces some risk of a correction. EUR/GBP may struggle to find very sustainable support beyond current levels.

Francesco Pesole

CEE: Busy week should lead to slightly stronger FX

The region has a busy week ahead. PMI numbers across CEE countries will be released today. In Poland and the Czech Republic, we expect industrial sentiment to deteriorate again more than the market expects. Later today, we will see the Czech Republic's state budget result for June, which should finally show a reduction in the record deficit. The National Bank of Romania will meet on Wednesday and we expect interest rates to be stable in line with the market. Then on Thursday, data from industry, retail sales and the state budget in Hungary will be published. In the case of industry, we expect a higher decline than the market forecasts. Later, we will see a decision from the National Bank of Poland. Rates remain unchanged, but this time a new forecast will be published. Given the lower inflation last week, we can expect a dovish tone pointing to rate cuts after the summer months. June inflation in Hungary will be published on Friday. We expect a further decline from 21.5% to 19.9% year-on-year due to a favourable base effect and a fall in food, durables and energy prices. Also on Friday, Czech industrial data will be published and S&P will release a rating review in Hungary. Given the downgrade to BBB- this January, we do not expect any changes this time.

In the FX market, the region should benefit today with a delay from Friday's upward movement of EUR/USD as well as the positive sentiment in Europe from the end of last week. On the other hand, the bad news for the Hungarian forint and the Czech koruna is the renewed rise in gas prices, which is once again becoming a strong player in this part of the region. A dovish NBP in the second half of the week should not come as a surprise to the market and therefore we do not expect much pain for the Polish Zloty. So overall, we are slightly bullish on FX in the CEE region this week. If gas prices calm down again, EUR/CZK should return below 23.70 and EUR/HUF to 370 EUR/HUF. EUR/PLN should stay below 4.450.

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