FX Daily: Risk assets feel the squeeze

High US bond yields and what seems to be a deteriorating environment in the Chinese financial sector are weighing on risk assets. Unless Chinese authorities can surprise with some powerful stimulus measures, the weaker Chinese renminbi can drag Asian and commodity currencies weaker and keep the dollar bid

USD: High US rates + poor overseas environment = strong dollar

The dollar starts the week on the strong side. Driving that strength remains robust US activity data, which is keeping short-dated US yields near the highs of the year. Looking at the calendar this week, tomorrow's release of US July retail sales and Wednesday's release of the minutes of the July FOMC meeting look unlikely to dent expectations that the Federal Reserve will keep rates at these 5%+ levels well into 2024.

The bigger driver of events in global FX markets looks to be developments in China. There certainly appears to be a 'sell China' mentality developing judging from the near 5bp rise overnight in China 5-year sovereign Credit Default Swap. USD/CNH is close to the highs of the year near 7.28

and the world is watching nervously over developments in the financial sector, where property developer Country Garden Holdings overnight suspended trading in 11 onshore notes issued by the company and its subsidiaries.

Ongoing difficulties in the Chinese property sector are exacerbating last week's poor set of Chinese data, which included deflation, trade and new loans. Looking ahead in China, analysts do not expect a rate cut in the one-year medium-term lending facility tomorrow (this would just weaken the renminbi further), but speculation is growing about a cut in the required reserve ratio to free up some liquidity. Barring some surprise stimulus measure this week, it looks like USD/CNH could press and break through 7.28 - a move that would drag Asian FX and the commodity complex with it.

DXY risks pushing up the 103.50/60 area this week.

Chris Turner

EUR: Trade-weighted looks OK

Even as EUR/USD softens, the euro trade-weighted index remains not far from the highs of the year. This serves as a reminder that it is the dollar story which is dominating. As one would imagine for mid-August, the eurozone data and official speaker calendars are very light. We will just see some 2Q23 GDP revisions and some ZEW investor surveys this week.

Unless there is some surprise turnaround in the Chinese story, it looks as though EUR/USD can break below support at 1.0925/30 - potentially as low as 1.0830/45. Equity markets will not be helping here, where futures markets call both Europe and US indices lower as investors want to learn more about the financial sector in China.

Chris Turner

GBP: Softening into key releases

As ING's UK economist James Smith discusses in our week ahead preview, the UK releases two important data sets this week: on employment and prices. Tuesday's release of the jobs data should continue to show average earnings coming in on the high side at 7%+ year-on-year. Sterling may have more trouble with Wednesday's July CPI data. Here, we expect services inflation to surprise on the downside and dent expectations for a further 50bp tightening from the Bank of England.

GBP/USD risks coming down to the 1.2590/2610 area today on the back of the stronger dollar.

Chris Turner

CEE: FX is gaining ground again

There is a lighter calendar in the CEE region this week. Poland's final current account and inflation numbers will be released today. We expect July CPI confirmation at 10.8% YoY. Looking forward, in August, annual inflation will be close to single-digit levels and will certainly fall below 10% YoY in September. The current account should show a smaller surplus than this year's average. On Wednesday, we will see 2Q GDP numbers across the region. We expect -0.3% YoY in Poland, -1.2% YoY in Hungary and +2.4% YoY in Romania, all more or less in line with market expectations. To complete the picture, the Czech Republic reported -0.6% YoY earlier. Also on Wednesday, core inflation in Poland will be released. We estimate that core inflation moderated to 10.5% YoY from 11.1% YoY in the previous month. Romania's industrial production for June will be published on Friday.

In the FX market, the US dollar remains the main driver in the region and we can expect that to continue this week. However, the market seems to be getting tired of the region's weakness over the past two weeks and against all odds, CEE FX is gaining ground again. Of course, we are seeing some improvement in the gas market, but the previous jump showed that this is not a topic for the market this time round. On the other hand, the US dollar and market sentiment are still indicating a rather weaker CEE FX. We thus see very mixed conditions. The calendar is rather weak locally and globally so we could see some stabilisation and calming from the previous week. Still, the main focus should be on the Czech koruna, which could move below 24.00 EUR/CZK for the first time since the Czech National Bank's FX intervention regime ended. Here, we see that the CZK is the only currency supported by the rate differential right now, which could help today. Also, the Hungarian forint has moved well below 390 and could test 380 EUR/HUF today, but as we mentioned, the signals are mixed and therefore we would not expect a bigger move today.

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