

FX Daily: Sell the fact, not the dollar

After yesterday's rally, the scope for a positive dollar impact from the Fed's expected 75bp hike today appears limited, and we could see some correction similar to recent announcements. However, we expect any correction to prove short-lived as the Fed's stance still argues in favour of a supported USD and the external environment should help safe havens



📉 USD: Post-FOMC correction possible, but likely short

The dollar enjoyed a corrective rally yesterday, rising mostly against European currencies as market fears about a gas crunch in Europe rose further (more in the EUR section below). Also contributing to the dollar move were some shockwaves sent across equity markets from US earnings jitters, and possible market positioning ahead of today's FOMC.

We suspect this pre-FOMC dollar rally has reduced the scope for a positive impact on USD today. A dollar correction after the FOMC announcement would not be out of the ordinary after all: when looking at the six hours after previous rate announcements, the DXY index dropped in six of the last eight occasions.

However – and as discussed in [our Fed preview](#) – we don't believe any dollar correction will have legs, as a still-hawkish message by the Fed accompanying the well-telegraphed 75bp hike today should continue to put a floor under the dollar over the coming weeks. The external environment, in particular, suggests that any post-FOMC dollar weakness may be extremely short-lived as global

risk sentiment remains unstable and Europe's gas-related troubles continue to argue in favour of a dollar consolidation or further strengthening.

DXY could drop to the 106.50 area today after the FOMC announcement but we still expect a return to 108.00 before the end of the week.

Elsewhere, in Australia, the 2Q22 CPI rose by 1.8% quarter-on-quarter, taking the inflation rate to 6.1% year-on-year. There is no question that the Reserve Bank of Australia will hike rates at its meeting next week (2 August). The latest inflation data was the most important since the last meeting when the Bank hiked the cash rate by 50bp to 1.35%, and since the last labour report, which set a new all-time low in the unemployment rate. The July RBA meeting was considered a choice between 25bp or 50bp, and the coming meeting looks like a similar discussion will be held with probably a similar outcome (50bp).

➔ EUR: A grimmer outlook

The euro has come under pressure with other European currencies as Russia is reportedly planning to keep squeezing gas flows into Europe, keeping them at minimal levels as long as the standoff over Ukraine persists. Meanwhile, EU members agreed on emergency plans based on a 15% gas consumption cut – even though some exceptions will be considered.

The message that is being conveyed to markets at the moment is that what used to be a black swan risk has now morphed into a very tangible and constant threat. A complete shutdown of gas supply from Russia to the EU is now looking much more likely, and something that is unequivocally being priced into European assets.

In FX, the euro, Swedish krona and Norwegian krone are looking particularly vulnerable. When it comes to EUR/USD, we could see a small correction higher (to 1.0170-1.0200) thanks to some “sell-the-fact” reaction after the FOMC announcement today, but the downside risks remain significant, and we suspect markets could take advantage of a temporary rebound in the pair to enter bearish EUR positions. A re-testing of parity in the near term still seems a very material risk.

On the domestic side, there are no market-moving data releases in the eurozone today, but keep an eye on upcoming comments by European Central Bank members, to which the euro is now showing a bigger sensitivity.

➔ HUF: NBH has prepared the forint for days to come

The National Bank of Hungary moved the base rate by 100bp to 10.75%. The forward guidance remained unchanged, favouring our view that the terminal rate could be around 13-14%. Overall, [the NBH showed open arms](#) to further rate hikes and confirmed the most open stance towards monetary policy tightening in the Central and Eastern European region.

In our view, this, combined with the rising interest rate differential, should protect the forint from another significant move above the 400 level, but on the other hand, it will not be enough for a strengthening below this level. Overall, we think this has reduced the forint's vulnerability to a possible dollar rally as a result of tomorrow's FOMC meeting or a meltdown in the European gas story, but it does not change the fact that its future path will be strongly driven by these issues. On the other hand, early progress in negotiations with the European Commission could be a positive factor. For now, however, we rather expect the EUR/HUF to stall around the 400 level.

CEE: Last man standing

The long-awaited FOMC meeting is approaching and it may be another trial by fire for the region after two weeks of relative calm. A more hawkish outcome than expected and a re-test of EUR/USD parity could be the trigger for a fresh sell-off in the region. Moreover, over the past two weeks, the willingness to raise interest rates further has fallen significantly in the Czech Republic and Poland, undermining the wobbly support for regional currencies. On the other hand, the National Bank of Hungary sent a clear signal yesterday that it is serious about tightening monetary policy (see above), but even so the forint remains fragile.

For the possible path of CEE currencies in the region in the event of a retest of EUR/USD parity, we used our short-term market equilibrium model based on interest rate differentials, market sentiment and the dollar index to estimate FX sensitivity to dollar moves. In our view, the Polish zloty is most at risk, which we calculate would move to 4.85 EUR/PLN (1.8% weaker than current levels). We see the Hungarian forint as second in line at 406 (1.4%). The koruna and leu should continue to remain under the safe wings of central banks. For the Czech National Bank, however, this would mean a renewed increase in the cost of FX intervention after two weeks of calm, which could signal further rate hikes or a premature reassessment of the interventionist approach for some board members.

Thus, the main topic after the FOMC meeting in the CEE region may be the weaker zloty and forint and the potential response from central banks. While the NBH is already doing its best to keep the forint around 400, the National Bank of Poland is still reticent and a weaker zloty could bring more significant interest rate hikes back into play.

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