FX Daily: Staring contest back in the streets

While the US is sticking to good old inflation spotting, Europe is preparing for the next round of the gas story. EUR/USD will remain under US domination, but the Central and Eastern European region is more likely to dance according to geopolitical squabbles

USD: CPI to cement the cycle

It has been a trendless week for the dollar so far, with very little follow-through from Friday's jobs-inspired rally. Today sees the biggest data event risk of the week – and probably of the month. US July CPI is expected to soften a little on a headline basis but nudge up on a core basis to just above 6% year-on-year.

Stubbornly high core inflation should support the Federal Reserve's position that its work is far from done. It should also support pricing in the US money market curve that sees the policy rate taken around 125bp higher in this cycle. Barring a massive upside surprise that can demand an extra 25-50bp or so priced into the back end of the curve (and sending the dollar a leg higher), we expect the inflation data to cement current tightening expectations and keep the dollar bid near the high.

Yet it is a long time until the next FOMC meeting on 21 September and barring any shocks, we feel that the dollar holding gains against the low yielders such as the euro and yen should not preclude a little more interest in some emerging high yield currencies.

105.70-107.00 are now the short-term parameters for DXY.

Chris Turner

EUR: Too many challenges

EUR/USD continues to languish near the lows and there does not seem a compelling case to buy it. As we discussed recently, medium valuation considerations do not show it as particularly undervalued. And the larger geopolitical event risks leave Europe more exposed than North America.

There is no European data of note today and EUR/USD will therefore be bounced around by the US CPI print. Declining levels of implied volatility suggest investors may be in no mood to chase EUR/USD out of a 1.0100-1.0300 range near term.

Chris Turner

CEE: The European gas story has reached the next level

Yesterday's news about the halt of gas supplies from Russia to Central and Eastern Europe has not caused much damage so far. Of course, further developments, especially the length of the supply stoppage, will be key. Purely in terms of energy dependence, Hungary is the most exposed to problems with supplies from Russia, followed by the Czech Republic. At the same time, the statistics on gas in storage are negative for Hungary. For the time being, both countries report that they have enough gas in reserve to last several weeks and keep the economy running as normal. However, no one will want to test what the reality is.

In the FX market, so far, the only visible reaction within CEE has been in the Hungarian forint, which we previously identified as the most vulnerable. Of course, in the coming days, this story will be in focus and drive the direction of FX markets. We see strong potential here to trigger difficult times for the region.

Frantisek Taborsky

CZK: Tricky inflation print to test CNB pain threshold

After Poland and Hungary, July inflation will be published today in the Czech Republic, and we think it will be the trickiest reading so far this year. July will bring a third round of energy price hikes and this time, the month-on-month jump should be a record. However, the problem is the uncertain ratio of fix/float contracts and the approach of the statistical office to such a massive jump in energy suppliers' price lists. Overall, we feel comfortable on the high side of estimates and believe the market may be underestimating these price changes. Thus, we expect inflation to jump from 17.2% to 18.5% today, while the market is expecting 17.9%. The central bank expects 18.8% in its new forecast, but even a higher number cannot be ruled out at this point. For the Czech National Bank, however, we believe the pain threshold is high given that any surprise will come from energy prices, which the new board places on the cost side, thus out of the central bank's reach.

From a market perspective, just a few days ago, we would have expected the news to fuel hawkish expectations that the central bank might react anyway. However, yesterday's 20bp jump in the short end of the curve, presumably in preparation for today's inflation, and profit-taking, should limit that market reaction. On the FX front, the market remains safely away from the 24.60-24.70 level after last week's CNB meeting and for now is vainly gathering strength for another stage of attack against the central bank, which has been defending the koruna.

Frantisek Taborsky

Author

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com