

## FX Daily: Steadying EUR/USD gives risk room to rally

For a change, Europe dominated the headlines yesterday. Upside surprises in August headline CPIs across the region brought the hawks out in force and triggered a sell-off in European bond markets. With the 9 September ECB meeting becoming a little more interesting, EUR/USD can stay supported short-term. This favours a mildly pro-risk environment



### 📉 USD: Taking a back seat

After much focus last week on the Jackson Hole speech and what it means for Fed tapering, attention has turned more to Europe this week. Below we discuss what ECB commentary may mean for EUR/USD short term.

For the dollar itself, we still favour a benign environment. Here, even a strong nonfarm payrolls figure on Friday (look out for ADP jobs data today expected at +638k) does not mean the dollar has to rally hard. Yes, it can cement views that the Fed may announce tapering in September - to start in November - but the dovish Fed under Jerome Powell looks unlikely to

hawkishly surprise markets with an early or aggressive Fed taper.

In fact, the clear signs of [ebbing consumer confidence](#) in US will very much support the gradualism under the Fed. And we suspect we will hear more from Powell on efforts to break the link between tapering and tightening.

A neutral to slightly softer dollar environment into Friday can allow local stories to win through. Chile surprised last night with a 75bp rate hike and joins the likes of Brazil with some very aggressive tightening. Brazil releases 2Q GDP today and remains on course to hike 100bp again in late September. And commodity FX has bounced back surprisingly quickly - with softer Chinese PMIs not having much impact so far. Indeed, Chinese equities have already underperformed global benchmarks by 35% this year and there is a case to be made that the bad news is already priced in.

Unless the European bond market sell-off gets out of hand and destabilises US Treasury yields, we would favour a slightly pro-risk environment near term.

## EUR: Round one to the hawks

The European Central Bank hawks were out in force yesterday and used the opportunity of 3% headline inflation to argue in favour of reducing pandemic stimulus or the Pandemic Emergency Purchase Programme. Both Klaas Knot and Robert Holzmann would have resisted what turned out to be a very [dovish meeting in July](#) and can now be expected to make their case at the 9 September ECB meeting.

Today, we have heard from ECB VP Luis De Guindos. He has been more equivocal about the need to gradually reduce emergency stimulus, but the tone of his [interview](#) with El Confidencial was upbeat and promised upward revisions to ECB growth forecasts at next week's meeting.

Unless we hear from the doves later this week, the idea that the PEPP scheme is up for debate in September could lend a little more support to the EUR and also German Bund yields, where our strategy team sees a further 5-10bp of upside. We should not get carried away, however. Having shifted strategy as recently as July, our team believes that heavy-hitting doves like Christine Lagarde and Philip Lane would not allow an ECB 'taper' to emerge ahead of the Fed and at this stage we believe PEPP will stay at its current elevated rate.

In our review of the [Jackson Hole meeting](#), we had felt that the dollar would weaken but that EUR/USD would struggle to make it much above the 1.1850 area. Given that the 9 Sep ECB meeting has become that little bit more interesting, expect EUR/USD to stay supported - but it might require some centrists shifting towards taper for EUR/USD to decisively break to the upside. ECB's Jens Weidmann speaks today at 14CET. His hawkish views should be well telegraphed already, but some forceful comments could see EUR/USD edge back to 1.1850 again.

Hints of a less dovish ECB have also given EUR/CHF a lift, where a break above 1.0840 resistance will be most welcome by the Swiss National Bank.

## GBP: Don't get carried away

EUR/GBP is nudging higher on the back of some independent EUR strength, but there does not seem a strong case for EUR/GBP to break sharply above 0.8600 just yet. There is still much doubt about what the ECB will do next (our team favours dovish settings retained), while the Bank of

England is more formally looking to get the tightening cycle underway - probably in late 2022.

A greater chance for EUR/GBP to break higher probably comes later in the month when extensions on Northern Ireland trade adjustments expire and the mood music between London and Brussels could deteriorate once again.

## CE3: Hawkish shift

CE3 FX enjoyed a good rally yesterday, buoyed by good GDP data and in Poland's case an August CPI print way above expectations. As our Polish team discusses [here](#), the 20 year high in CPI will put pressure on the MPC to start its hiking cycle in November. Our team notes that the proposition for a hike is now probably backed by four of the ten MPC members, but a hawkish shift by Governor Adam Glapinski himself is really required to get the hike over the line.

As above, the more benign EUR/USD environment - which probably lasts into next week's ECB meeting - can provide a supportive backdrop for CE3 FX in general - even though the tightening cycles look fully priced in Hungary and the Czech Republic. Despite this pricing, as we've seen many times before, unless the external environment turns more difficult, investors are reluctant to sell out of CZK longs. This is especially so since the Czech National Bank would be tempted to hike more if the koruna does not appreciate in line with its expectations. We favour EUR/CZK to the 25.20 area later this year, but really need to see a few more Polish hawks emerge to drive EUR/PLN significantly below 4.50.

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