

FX Daily: Technical vs real

After evidence that the US is in a technical recession, expect assets' sensitivity to data to be even more pronounced. This week, the key release is the non-farm payrolls. We do not expect this data to flash red warning signals on a 'real' recession, leaving the prospect of a 50bp Fed hike in September alive. We suspect more dollar weakness will be selective



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➔ USD: Hard to get bored in markets these days

July was a very eventful and volatile month for global markets, and we doubt we'll navigate much calmer waters in August. The switch to a fully data-dependent approach by the Federal Reserve and the European Central Bank means that incoming data releases will have a magnified impact on most asset classes, and there are still geopolitical and virus-related threads that can have major implications for the global outlook and should keep uncertainty elevated.

After the rather grim 2Q GDP numbers in the US last week, markets are now actively seeking evidence of how much of this technical recession is "real". The main gauge to watch is the unemployment rate, as a fully-fledged recession needs to see a weakening of the labour market. Friday's US non-farm payrolls will therefore be the main highlight of the week. Our economics

team is forecasting a 200k increase, with the numbers still being held back by labour shortages, and the unemployment rate staying at 3.6%. If a worsening outlook suggests 75bp increases are now off the table, a 50bp move would still be warranted against this still good labour-market backdrop.

Some focus will also be on activity surveys, starting with today's ISM Manufacturing index, which we expect to fall to 51.5 (consensus 52.0) from 53.0 last month. Once again, this should all but endorse the narrative of a slowing US economy, which should warrant a slower but not a stop to Fed tightening in autumn.

We'll also start hearing from Fed speakers again this week, and expect the market's sensitivity to be quite elevated in this case, too. While no FOMC members are scheduled to speak today, one dove (Charles Evans) and two hawks (Loretta Mester and James Bullard) are due to deliver remarks later this week.

On the FX side, the repricing lower in rate expectations sent equities higher and generated the perfect environment to unwind some of the quite extensive dollar longs last week. Our view for the coming days is that we'll not see the dollar entering a broad-based downtrend, and we could instead see only some selective strength in G10 against the greenback.

For example, the recent rebound in oil prices may keep the likes of Norway's krone and Canada's dollar supported, while lower yields and the re-pricing lower in rate expectations may help USD/JPY test 130.00. We suspect European currencies (like the euro and Swedish krona) may struggle to find sustained support given Europe's gas troubles and worsening outlook. The pound is facing the risk of a dovish re-pricing after the Bank of England meeting, while the Australian dollar may receive some support (although external factors should still dominate) as the [Reserve Bank of Australia may hike by 50bp tonight](#).

In our view, DXY should be able to hold above 105.00 by the end of the week. Although volatility is set to remain quite elevated.

➔ EUR: 1.0200 may remain the anchor

Amid a significant softening of the dollar environment last week, the euro stood out as being unable to stage a material rally despite some above-consensus GDP and CPI numbers. The recent price action does suggest that 1.0200 is becoming an anchor for EUR/USD, and we see this as a level that signals the markets' reluctance to re-enter long euro positions given the still very challenging and uncertain external woes to the eurozone outlook.

Our short-term fair value model seems to endorse this view, as it shows a risk premium of around 2.8% on EUR/USD. This means that the EUR is trading below what its short-term fundamentals would suggest, given its exposure to significant downside risks not included in the model – in this case, the risk of a full shutdown in Russian gas supply and its economic implications. We note that while normally a wide risk premium can imply a currency is close to rebounding, in some cases where tail risks are quite elevated (like during the Greek debt crisis or the 2018 Italian political crisis), a substantial risk premium can remain embedded into a pair for months.

Given the lingering uncertainty around the Russian gas story, we think EUR/USD may remain close to 1.0200 at least for this week. Incidentally, there are no major data releases to watch in the eurozone over coming days, nor any scheduled ECB speakers. Another factor to keep an eye on is

the emergence of the euro as an attractive funding currency in an environment where a stabilisation in risk sentiment is fuelling some fresh search for carry. This dynamic may be contributing to keeping a lid on the euro despite its pro-cyclical nature.

➔ **GBP: BoE 50bp hike may not be enough to lift the pound**

Expect a bit of a wait-and-see approach in GBP price action heading into Thursday's Bank of England rate announcement. A look at rate expectations shows that the market is now fully pricing in a 50bp move, which is also our base-case scenario.

Still, we see a non-negligible risk of some pushback against the market's hawkish pricing, which could trigger some weakness in the pound. That means that EUR/GBP may struggle to end the week below 0.8300 despite the euro's lack of bullish momentum, while GBP/USD could fall back to the 1.20-1.21 area.

⬆️ **CEE: The market will test the CNB's will to keep the koruna under control**

We start this week with a heavy load of data. Today we will see the region's PMI for July, a major leader of recession fears, which should show a further drop into contractionary territory, especially in Poland and the Czech Republic. On Wednesday, in Hungary, retail sales for June will confirm the slowdown with a soft landing. On Thursday, the [CNB board](#) meets for the first time under new leadership and we expect it to keep rates on hold at 7.00% for the first time since the first post-Covid hike in May last year. The central bank will also introduce a new forecast, which should be significantly more dovish than what we've been used to from the CNB. On Friday, it will be followed up by the Romanian central bank, which is only just accelerating its rate hiking cycle. We expect another 100bp rate hike this week to 5.75%, just like last month. Also on Friday, we will see Hungarian industrial production completing the [second quarter picture](#) and retail sales in the Czech Republic.

CEE currencies have not fully recovered from last week and the impact of the FOMC meeting, in our view. Although they strengthened [as we expected](#) at the end of the last week, especially the Polish zloty, we believe there is room to go a bit lower. We see the most room at the moment in the Hungarian forint, which is also supported by a fresh rise in the interest rate differential to new record levels. Therefore, we see room to go even slightly below 400 EUR/HUF at the moment, but geopolitical risks may continue to hamper new gains. The Polish zloty is back below 4.750 EUR/PLN and some room to go even lower closer to 4.72 remains. We think the Czech koruna will properly test the CNB's will to keep it below 24.60 this week. The dovish outcome of Thursday's meeting will bring a new wave of depreciation pressure, in our view, but it is still too early for the koruna to break out of the central bank's control.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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

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