

FX Daily: The 100bp narrative is on

Volatility around EUR/USD parity should continue to be elevated and to impact other USD crosses. With markets now considering 100bp by the Fed in July, a more decisive break below parity is possible today. The Central and Eastern European market remains in the shadow of a strong dollar and tries in vain to resist with a rising interest rate differential



📈 USD: Ongoing hawkish re-pricing

Only yesterday morning, the market had just finally priced in a full 75bp rate hike in July for the first time. In a few hours, an above-consensus US CPI reading (headline inflation jumped to 9.1%) and a surprise 100bp rate hike by the Bank of Canada changed the whole picture again. After these two events, markets have moved to seriously consider a 1.0% rate increase by the Fed in two weeks. At the time of writing, the OIS market is pricing in 90bp for July.

Regarding the BoC hike, we discuss the implications for the Canadian dollar in the CAD section below. When it comes to its spillover into the Fed pricing, we think that may be overdone. Canada has both a tighter labour market than the US and a more favourable commodity exposure – regardless of recent woes in the oil market – which ultimately argues that the economic resilience should prove more solid than in the US. In that sense, we doubt that yesterday's move by the BoC

realistically suggests something similar in the US.

When it comes to the CPI impact, the acceleration was certainly above consensus, but markets were already bracing for a headline rate acceleration and price pressure is expected to ease in July due to gasoline price contraction. Our call is still for a 75bp hike this month. However, the risk is that the market itself pushes the Fed to hike by 100bp, as some FOMC members may oppose the idea of a dovish surprise.

In all this, the dollar was on a roller coaster ride yesterday and volatility around EUR/USD parity (which was hit yesterday) should continue to be elevated and to impact other USD crosses. We think that the current re-pricing higher in Fed rate expectations can – along with other factors – keep the dollar supported at this stage, and the risk of a more decisive break below 1.000 in EUR/USD can strengthen the greenback across the board.

Today, PPI data will be watched in the US, while scheduled comments by arch-hawk Chris Waller bear the risk of further inflating speculation around a 100bp move.

↓ EUR: Ready to re-test parity

Yesterday, US CPI numbers pushed EUR/USD 2 pips below parity. That was followed by an immediate rebound which sent the pair back above 1.0100. Some option-related activity around the key technical support appears to be behind the moves, and we may well continue to see elevated volatility around parity. EUR/USD is trading at 1.0017 at the time of writing.

As discussed in the dollar section above, the potential re-pricing higher in Fed rate expectations is another element of downside risk for EUR/USD, along with the already negative macro picture and the growing risk premium related to the Russia-EU spat on gas supply. In our view, another attempt at breaking below 1.0000 appears likely over the coming sessions, and this time we could see a more decisive move lower. We continue to see 0.9800-0.9900 as a potential short-term bottom for EUR/USD.

Today, markets will keep an eye on the EU Commission's Summer Economic Forecasts – a draft showed 2023 growth has been cut from 2.3% to 1.4% – and on a speech by Mario Centeno in Portugal. There are no other data releases to highlight in the eurozone today but watch for Italian political developments, as the 5-star Movement said it would not support the government in a confidence vote today, which might trigger resignations from Prime Minister Mario Draghi and raise the risk of early elections. Surely, another potentially negative event for EUR/USD.

Elsewhere in Europe, the first round of votes in the UK Conservative party leadership contest saw Rishi Sunak secure 88 votes, ahead of Trade Minister Penny Mordaunt (67) and Foreign Secretary Liz Truss (50). This cemented consensus views that Sunak is indeed the front runner in the race to become the new prime minister, although a recent poll seemed to suggest he would lose in a run-off against either Mordaunt or Truss.

Another vote today will trim the list of candidates further. For now, the impact on GBP is set to remain quite limited though, and EUR/GBP should largely remain a function of EUR dynamics.

↓ CAD: Bank of Canada going big

The Bank of Canada surprised markets and economists' consensus by delivering a [100bp rate hike yesterday](#). In its statement, the Bank highlighted the breadth of price pressure – "More than half of

the components that make up the CPI are now rising by more than 5%" – and the surge in inflation expectations – "more consumers and businesses are expecting inflation to be higher for longer".

The move is raising upside risks to our current forecasts for two 50bp rate increases in September and October and 25bp in December. Market pricing seems to suggest investors are expecting more front-loading, with a 75bp move in September (almost fully in the price), followed by a 50bp move in October. Interestingly, markets are still expecting "only" 125bp of tightening by year-end, which suggests further room for hawkish repricing.

Looking at the FX implications, we think that the BoC's faster hiking could help the currency in the longer run but for now, external factors (eg, global risk sentiment, oil prices) continue to play a much bigger role and may keep CAD gains capped in the near-term. However, with CAD now sharing the highest policy rate in the G10 (2.50%) with the New Zealand dollar, and still counting on a decent economic outlook thanks to positive commodity exposure, the chances of USD/CAD moving back below 1.25 by year-end (barring a prolonged USD strength) have risen – in our view.

CEE: The market remains in the shadow of a strong dollar

In Poland, President Duda will sign a mortgage moratorium law today that includes a credit holiday for PLN-mortgage borrowers for a total of eight months in 2022 and 2023. The law enforces replacing the WIBOR rate in bank deals, and assumes banks will put additional means into the borrower support fund FWK.

In the Czech Republic, new CNB Vice Governor Eva Zamrazilova said in her first TV interview that she expects inflation to rise further but the peak is near. She said the effect of tight monetary policy is visible on the economy and she sees inflation dampening. She did not want to answer the question of raising interest rates because of the long period until the next CNB meeting (4 August). However, she conditioned the decline in inflation on moderate labour union negotiations. If wage growth was high, she said, this would require further monetary tightening, while the period of high inflation would be longer.

Hungary has declared an energy emergency, which includes a ban on energy exports. It has also abolished the price cap on energy for households with above-average consumption and plans to increase domestic natural gas production. The set of measures, which will come into force in August, is intended to prepare the country for the coming winter. Meanwhile, today the National Bank of Hungary decides, as every week, on the 1-week deposit rate, but we do not expect further increases after the last massive hike.

On the FX front, CEE markets are still overshadowed by the strong dollar. The forint has weakened back to 410 and we see room for the second half of the week to weaken further to 412 EUR/HUF. The zloty also lost ground and moved back above 4.80, but we still believe that the rising interest rate differential will not be ignored forever and has the potential to move back below this level. Moreover, it could get additional support from rates, which still haven't fully recovered from last week's dovish National Bank of Poland meeting. The koruna remains slightly below 24.40, our level from the previous days and in our view the potential for further appreciation has been mostly exhausted, which may support a resumption of short positions in the market.

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