

FX Daily: The dollar's "pivot" hasn't arrived yet

Yesterday's long-squeeze is not a sign of a longer-lasting soft period for the dollar, in our view. Upside risks for the greenback remain material due to an unstable global risk environment and still broadly supportive Fed stance. But from now on, expect higher sensitivity of USD to data, starting with today's GDP figures. German CPI will be in focus, too



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➔ USD: Soft dollar momentum shouldn't last long

Similar to what had happened in the aftermath of six of the previous eight FOMC announcements, a "sell-the-fact" reaction and long-squeeze in the dollar was triggered yesterday. In particular, markets seemed to cling on to the notion that the Fed will slow down tightening from now, which resulted in an equities rally as well as some re-pricing lower in rate expectations for the remainder of the year. The OIS curve currently embeds 100bp of extra tightening at the September, November and December meetings combined.

As discussed in our [FOMC review](#), we do expect the Fed to switch to 50bp in September, but vague

forward guidance and the migration to a fully data-dependent approach mean that a lot can change from now until the next meeting. We also think that – in a similar fashion to what the ECB did to the euro early this month – the dollar will now become more data-dependent, as markets will be searching for any evidence on the inflation and growth side that could warrant a dovish shift by the Fed.

Speaking of recession, while Chair Jerome Powell seemed to retain a rather optimistic approach on the matter, today's GDP numbers will be a first test of the dollar's reaction function to incoming data. Consensus is centred around a 0.5% quarter-on-quarter annualised growth rate in 2Q, and our economist's baseline scenario is a 0.4% reading, even though we highlight some downside risks (even a second consecutive negative quarterly reading) given the swings in inventories and trade figures.

Looking at the coming weeks, our view is that the post-FOMC dollar weakness may start to fade quite soon. The road to recovery for global risk assets is still long and quite bumpy, as the magnitude of a global slowdown remains high. Geopolitical risks also remain elevated, making the outlook for commodity prices uncertain. In addition, our suspicion is that markets should retain most dollar longs until the Fed is giving clearer signals that it is pivoting to a less hawkish stance. Our baseline scenario is that the dollar will consolidate around these levels and may re-strengthen from now until the September FOMC meeting. Expect a heightened sensitivity to data to keep volatility high.

➔ EUR: German CPI slowing down again?

EUR/USD received a bump after the FOMC and is back at the 1.0200 gravity line, but – as discussed above – we don't expect the dollar's soft momentum to linger for much longer. This means that downside risks over the coming weeks for EUR/USD remain material, and obviously quite tied to further developments on the Russian gas story.

Today, however, the focus will be on data releases both in the US and the eurozone. German CPI figures will be watched very closely ahead of tomorrow's eurozone-wide figures and could have a quite tangible impact on the euro. Should there be evidence of some further deceleration – albeit likely quite marginal – from the 7.6% July headline reading, the euro could come under some pressure. However, uninspiring GDP figures out of the US might have a similar impact on the dollar and that could keep EUR/USD attached to the 1.0200 mark today.

On the ECB side, we'll hear from Bank of Italy's Governor Ignazio Visco today. Expect a larger market reaction to any comment about the central bank's Transmission Protection Instrument. The 10Y BTP-Bund spread touched the 240bp mark yesterday - very close to the 242bp June high - as markets seem to retain some doubts about the scope of TPI intervention under a politically-motivated widening in sovereign spreads.

➔ GBP: Still no domestic drivers

With the exception of some headlines about campaign pledges by Liz Truss and Rishi Sunak, there simply isn't much that markets are looking at in terms of domestic drivers for GBP. The data calendar is set to be very quiet into next Thursday's Bank of England rate announcement, ahead of which markets are pricing in around 45bp of tightening.

Expect cable to keep being driven by the dollar and EUR/GBP to be driven by the euro. We think

GBP/USD is still at risk of a return to or below 1.2000 in the coming weeks, while EUR/GBP may stay around 0.8400 but is facing downside risks due to uncertainty over Russian gas supply.

👆 CEE: Get up and back to work

The region survived another day and the FOMC outcome had no significant implications for it either way, in our view. However, the market already took precautionary measures yesterday, sending CEE currencies into the Fed meeting at the weakest levels in two weeks. Nevertheless, the end of the world did not take place and the region is waking up to the fight to regain its previous position.

Just as we saw the Polish zloty as the most vulnerable, we believe it can now go for the biggest gains below the 4.75 level. However, tomorrow we will see Polish inflation for July, which may give the National Bank of Poland ammunition for some dovish rhetoric and give the market a reason to erase the last vestiges of its expectations for a more significant rate hike. We see the Hungarian forint back closer to its favoured 400 level, which should give the National Bank of Hungary confidence that it has the situation under control and deliver "only" a 75bp deposit rate hike today, as promised on Tuesday.

The koruna will get a dose of relief and a chance to get below 24.60, which has proven to be the level where the Czech National Bank has drawn a line for its FX intervention over the past two days. In addition, the drop in pressure on a weaker koruna also gives comfort to the new board, which we believe is planning rate stability for next week's meeting, the first time since last May. On the other hand, we must not forget that the world is not all about the Fed, and the CEE region remains sensitive to events in Europe, led by the gas story.

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