# FX Daily: Too early to jump off the dollar boat

The dollar correction yesterday was due to better risk sentiment and a shrinking in the Fed's rate advantage against other central banks. But we suspect that the pricing of tightening cycles in many countries outside of the US is too hawkish, and risk assets may struggle to recover just yet. It's a key day for Italian politics, as PM Draghi speaks to lawmakers

## USD: The correction may not last long

The dollar suffered a sizeable correction across the board yesterday, which was primarily fuelled by two factors: a significant rebound in global risk assets, and a growing narrative of other central banks closing the gap with the Federal Reserve. From a more technical perspective, it is likely that some position-squaring moves in the oversold dollar exacerbated the magnitude of the correction.

Now, the question is whether yesterday’s moves have marked the first stage of a dollar depreciating trend from its cyclical peak. While we wouldn’t completely rule this out, the risks to a bearish dollar scenario remain quite elevated.

First, the perceived shrinking of the Fed's advantage over other central banks appears – in our view – based in many instances on excessively hawkish pricing for tightening by those central banks. The most notable examples are the European Central Bank and Bank of England. While a 50bp move at their next meeting is looking more likely, markets are currently pricing in 200bp of tightening from both central banks by May 2023, which in our view is too hawkish considering both the eurozone and the UK are looking at very challenging growth outlooks. Conversely, the 200bp of tightening priced in for the same period for the Fed are in line with FOMC's latest dot plot projections and this doesn't seem exaggerated given the US's lower exposure to global headwinds (like a drop in Russian gas supply).

Second, a sustained dollar depreciation will need to be accompanied by a significant stabilisation and some recovery in global risk assets. That may still prove challenging in a high-interest rate environment, and while markets continue to deal with the incumbent threat of a global recession.

Our view is that even if the dollar did bottom out in the past week, the path to a sustained depreciation remains challenging, and would most likely be very gradual from this point on. And risks of other rounds of dollar strengthening remain very elevated.

Today, the US data calendar only includes existing home sales data, after yesterday's new home starts figures came in below expectations. Expect limited market impact, and most dollar moves to be driven by non-US factors.

Elsewhere, keep an eye on Canada's inflation numbers, which are expected to have accelerated further in June and should endorse the Bank of Canada's aggressive policy tightening.

## EUR: A key day for Italian political picture

EUR/USD jumped well above 1.0200 yesterday following the news that the ECB is actively considering a 50bp rate hike tomorrow. Chief Economist Philip Lane will reportedly make the official proposal at the meeting, and markets are now attempting to gauge how many members of the Governing Council would be happy to back such a move. So far, only three members explicitly backed a half-point hike before the "quiet period" kicked in, and markets are currently attaching a 50% chance of a 50bp move tomorrow.

We outlined four different scenarios for the ECB ahead of the July meeting, along with the potential market impact. Our view remains that even in the event of a hawkish surprise, driving the euro (from a broad-base perspective) sustainably higher remains a hard task considering the worsening growth outlook for Europe. As discussed above, a significantly weaker dollar may not be on the cards just yet, and this, in our view, should cap EUR/USD in the near term.

The Russia-EU spat on gas supply will remain in focus today as we head into tomorrow's ECB risk event. Moscow said that it is ready to supply as much gas to Europe as needed, although it flagged a potential reduction in supplies if a turbine is not received on time from Canada after repair. The feeling among EU member states remains that some cuts in gas consumption will be needed, and that the risk of a larger drop in gas flows from Russia is still high.

Another thread to keep an eye on in Europe: Italian Prime Minister Mario Draghi will speak before parliament today, and while he's due to formalise his intention to resign, the chances of a new agreement between key parties to support a second government led by him appear to have risen again. We spoke here about what options Italy is facing. After today's speech by Draghi and the consequent round of negotiations with major parties, signs that Italy is indeed getting closer to early elections would weigh on the euro. On the other hand, the announcement of a new government led by Draghi could put a floor under the euro heading into tomorrow's ECB meeting.

In any event, volatility should remain the name of the game for EUR/USD. The eurozone's data calendar includes consumer confidence figures for June today.

## GBP: CPI no game changer for BoE

UK CPI came in only slightly above consensus, accelerating from 9.1% to 9.4% year-on-year in June. The core rate appears to have peaked though, and there are signs that the supply-constrained bits of CPI are cooling. In our view, today's release will not be the key factor to tilt the August BoE policy decision in one direction or the other.

Instead, it appears to be a global central bank tightening story that is pushing the Bank to consider a larger rate hike at this stage. Yesterday, Governor Andrew Bailey quite explicitly opened the door to a 50bp move, and that remains our base case for the August meeting.

GBP/USD should remain a function of dollar moves, while EUR/GBP may stay supported unless Italian politics drags the euro back lower.

## HUF: Forint below 400, but isn't it too soon?

As we mentioned on Monday, the Hungarian forint is the biggest surprise of the last few days. While back on Thursday we saw values around 410 EUR/HUF, we are currently around 398, the strongest value since the beginning of July. The positive newsflow regarding Hungary's negotiations with the European Commission has finally unlocked the giant potential for the forint to appreciate. Of course, the stronger euro also plays a big role in this. However, we are cautious about betting on a new strengthening trend for now. Positive news is coming mainly from the Hungarian government, while recent statements from European Commission representatives are not so optimistic. It is likely that the agreements to conclude the Rule of Law procedure will come sooner, but we still think it will be at the end of the summer at the earliest. Market rates, while not far from their recent peak, lost a bit yesterday and we don't see many potential triggers for rate payers for the next few days.

Thus, global factors, led by EUR/USD and the ECB, will be crucial for the rest of the week. EUR/USD rally may be running out of steam soon, and we could see some fresh pressure on the Central and Eastern Europe region and the forint will have a hard time staying below the 400 level. In addition, the Fitch rating review will be published on Friday, where we see an elevated probability of a downgrade in the outlook for Hungary, similar to the Czech Republic in May.

## Authors

**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

### Disclaimer