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FX

FX Daily: Trading the pipeline

The EU will hold an emergency meeting today to deliberate on plans to cut gas consumption by 15%, as Russia reduced Nord Stream flows further citing technical issues. With the US market more likely to stay in a wait-and-see mode ahead of tomorrow's FOMC, expect most of the excitement for G10 FX to come from Europe today. In Hungary, expect a 125bp rate hike



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➔ USD: Some calm before the Fed?

The dollar started the week on a generally weak footing, especially against commodity currencies that benefitted from some recovery in oil prices and tentative signs of stabilisation in equity markets. Overnight, US and European stock futures have slipped again despite a good performance in Chinese stocks, and that could limit the downside for the dollar today.

We may also see a wait-and-see approach by markets today ahead of tomorrow's FOMC meeting, which could favour a lower volatility environment in USD-crosses. On the data side, markets will watch the Richmond Fed Manufacturing Index, new home sales, and the Conference Board Consumer Confidence Index, which are all likely to have fallen further. Despite the relevance of the consumer spending and housing narrative in the recession discussion in the US, the vicinity of a near-certain 75bp hike by the Fed tomorrow should limit

the impact of the dollar of any data releases today.

Incidentally, developments in Europe may continue to be a bigger driver of G10 FX dynamics for today. Any surprise development in the EU-Russia natural gas saga will impact the bloc of European currencies, and by extension the dollar. But expect fewer idiosyncratic dollar moves for today.

➔ **EUR: EU decision on gas reduction in focus**

The EUR continued to show some relatively elevated intraday volatility yesterday, despite remaining largely attached to the 1.0200 gravity line. Today, all eyes will be on the EU emergency meeting to discuss last week's European Commission proposal to reduce gas consumption by 15%. The original EC draft has been heavily revised and the new proposal reportedly includes a number of exceptions and lower targets based on each country's specific circumstances. The meeting follows Gazprom's announcement that it will further cut gas flows via the Nord Stream link to around 20% of the pipeline's capacity due to technical issues.

Let's see whether the proposal goes through today and above all with what degree of compromises. That should help markets assess both the state of the supply-demand imbalance in the gas market for the remainder of the year and the economic implications for European countries.

Meanwhile, the perceived risk of a complete shutdown of Russian flows via the Nord Stream pipeline has risen once again. Such a scenario has now transformed from a black swan to a constant and tangible threat, and one that could continue to put a cap on buying interest for European currencies.

Looking at the EUR impact, it is undoubtful that markets are partly pricing in both a gas consumption reduction and a cut to Russian gas flows. But as discussed above, we think the constant threat of a complete shutdown in gas supply from Russia should put a cap on any recovery in EUR/USD for now, and possibly trigger a new drop to parity.

The ECB factor needs to be considered too, as we heard some statements from Governing Council member Martins Kazaks yesterday backing another large rate hike in September. Interestingly, he seemed to tame his hawkishness in regard to later moves due to the clouded economic outlook. Let's see whether this notion of front-loading receives more consensus from other ECB members. However, there are no scheduled speakers – nor major data releases – out of the eurozone today.

With markets pricing in 45bp of tightening in September and a total of 115bp by year-end, we still see a limited ability for the ECB to “talk up” the euro for the time being, especially given mounting external woes in Europe.

➔ HUF: NBH will prepare the forint for Fed hit

Today, [we expect](#) the National Bank of Hungary (NBH) to raise the base rate by 125bp to 11%, while the consensus expects only 100bp. Market expectations are hard to read these days given the massively elevated BUBOR and poor liquidity in the FRA market. But we stand on the hawkish side of the market for today's decision given that we are still waiting for inflation to peak in Hungary.

Moreover, the NBH is clearly the most open central bank to further rate hikes in the CEE region at the moment. This should be confirmed by the hawkish tone and the promise of further rate hikes to a terminal rate of around 14%. However, even if we see some positive momentum for the forint, we do not expect it to be long-lived. We continue to believe that the forint should stay around the 400 level or rather above it and wait for tangible progress in the negotiations with the European Commission regarding the Rule of Law.

➔ PLN: Fundamentals still point down

The Polish zloty briefly touched 4.70 EUR/PLN yesterday, for the first time since the beginning of July, against our expectations. Although the fundamentals clearly point to weaker levels, the short-lived upward movement of EUR/USD and the liquidation of short positions probably helped the zloty in the opposite direction.

However, this does not change our negative view and, on the contrary, we believe current levels increase sensitivity to Wednesday's Fed meeting, which may trigger another sell-off in the CEE region. For now, we expect a return to at least 4.75, but until Friday's inflation print the fate of the zloty is fully in the hands of the Fed meeting.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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