FX Daily: Waiting game keeps the dollar in demand

Another mixed US jobs report on Friday has maintained choppy conditions in FX markets. While consensus expects the dollar to edge lower through the year, we are yet to see both the decline in inflation and activity (particularly jobs data) that would cement this trend. Key inputs to FX markets this week will be Thursday's CPI data and the Treasury refunding

USD: CPI and quarterly refunding will be the highlights

Friday's release of a mixed US July jobs report was enough to deliver some calm to the US bond market. Recall that the sharp sell-off at the long end of the curve had upset benign market conditions on Wednesday and Thursday last week. Lower headline employment in July saw 10-year Treasury yields drop nearly 15bp on Friday and investors jump back into their preferred high-yielding currencies such as the Mexican peso.

Looking ahead, we see two key US highlights this week. The main event will be Thursday's release of July CPI figures. Despite base effects nudging the YoY rate higher, MoM readings should deliver another benign 0.2% outcome at the core level and provide another piece of disinflation evidence for the Fed. The problem for FX markets is that it seems that disinflation is not enough to get the dollar lower. Instead, we also need to see signs of softening activity - especially in the labour markets. Unless initial claims spike on Thursday or consumer sentiment falls sharply on Friday, there are few real signs of softer activity coming through just yet.

The second highlight of the week will be the US Treasury's quarterly refunding, where a collective $103bn of three, ten, and thirty-year US Treasuries are auctioned Tuesday through Thursday. It is very rare to have a bad Treasury refunding - e.g. consistently low bid to cover ratios or other such metrics. But the risk is that dealers build concessions into bond prices ahead of the auctions - keeping US yields firm and the investment environment mixed.

On the face of it then, this week looks unlikely to trigger the kind of benign dollar decline around which the Rest of the World currencies can rally. Additionally, events in the Black Sea and what they could mean for food and energy prices could keep investors nervous about embracing disinflation trends. For today, we doubt Fed speakers will have a meaningful impact on the dollar and can see DXY trading well within a 101.80-102.80 range.

Chris Turner

EUR: 100 day moving average seems to be holding EUR/USD

The softer headline US employment figure provided something of a reprieve to EUR/USD on Friday. The pair also seemed to find support around the 100-day Moving Average - which is now just above 1.0920. Whilst that holds, some trend followers will be able to hang onto their bullish EUR/USD views.

As mentioned above, it looks like another mixed week for FX markets. This suggests EUR/USD should largely be range-bound around 1.10. Locally we have some second-tier European data and an ECB consumer expectations survey (Tuesday) as inputs. However, these look unlikely to move the needle on market pricing for one final ECB hike by year-end. Currently the market prices around 18bp of tightening by December.

Chris Turner

GBP: Sterling has not moved much since BoE

The sterling trade-weighted index is only marginally weaker since the Bank of England 'only' hiked by 25bp last Thursday. Market interest rates are slightly lower, but investors have not given up pricing two further 25bp hikes by early next year. At present, we look for one more hike to 5.50% in the Bank Rate (probably at the September meeting) before the BoE is prepared to go into a formal pause. This all points to a range-bound sterling over the next couple of months, but we retain an upside bias in EUR/GBP into year-end.

On the UK calendar, this week will be BoE Chief Economist, Huw Pill, speaking at 1815CET today and then not much data until Friday's release of 2Q GDP numbers. For Cable, we see 1.2590/2620 as important support and what should be the lower boundary of this week's range.

Chris Turner

CEE: No change in rates or tone in Romania

Another busy week in the CEE region. Today, the Czech Republic's industrial production, foreign trade, and construction numbers will be released. Industry is showing signs of recovery. However, the only growing sector is automotive. Later today, we will see a decision from the National Bank of Romania. A rate change is not on the table, however, a new forecast will be published and we would like to hear some comments on the current inflation and leu developments. Inflation and budget numbers will be released tomorrow in Hungary. We expect a massive drop in July inflation from 20.1% to 17.3% YoY. The central bank expects 17.5% and the market 17.7% YoY. We don't expect much change from June for the state budget, which would be good news for Hungarian bonds. Then on Thursday, the Czech Republic's July inflation will be released. We expect a further decline from 9.7% to 8.7% YoY, in line with the market. The Czech National Bank expects 8.9% here.

In the FX market, we have seen high volatility and weakness in the region driven mainly by the US dollar and we do not expect much change this week. EUR/CZK has moved to 24.25 after the CNB intervention regime ended and the market does not seem to want to test higher levels for now. However, we think Thursday's inflation release has the potential to surprise to the downside, which should raise the bets for a central bank rate cut, and the market may test weaker CZK levels again. In the meantime, we expect a rather stable CZK of around 24.25 EUR /CZK.

The Hungarian forint finally rebounded and erased some losses on Friday. However, the main driver still seems to be the US dollar, which cannot offer much positive for EM FX this week either. So maybe we can see some recovery in the forint today, but a strong USD and a big jump in inflation down for HUF is not a positive factor.

Frantisek Taborsky

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com