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Weekly Report

Weekly FX Market Update

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, CFA, Roman Ziruk & Itsaso Apezteguia

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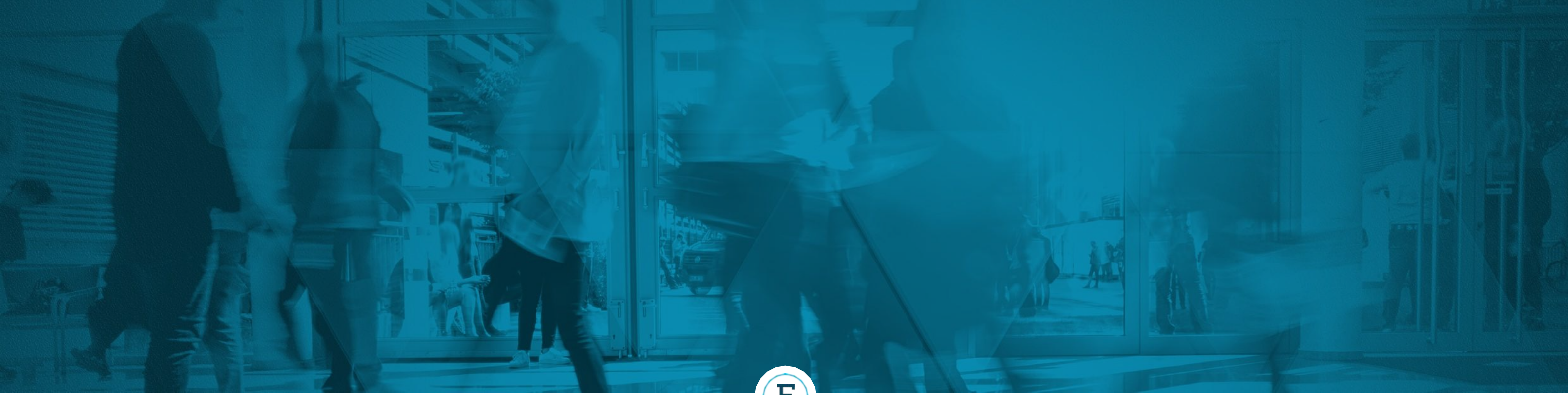


Signs of US slowdown slam dollar, euro mixed on ECB hawkish surprise

Disappointing economic data out of the US brought yields down worldwide and removed any chance of a 100 basis point interest rate hike from the Federal Reserve this week.

The surprise 50bp hike from the ECB had surprisingly little immediate impact on the common currency, which nevertheless joined in the general bounce back against the US dollar.

Wednesday's Federal Reserve meeting will dominate financial news this week. Also important will be the inflation report out of the US and the Eurozone, both out on Friday. The key question for markets is how fast the slowdown in activity evident in most economic areas will translate into downward pressure on inflation data. This will be the key question the Federal Reserve will be grappling with at its July meeting.

CZK

The Czech koruna underperformed its peers last week, selling off slightly against the euro. However, a recent uptick in EUR/USD and the strengthening of koruna's major peers suggest the environment has turned more favourable.

In the coming days, the market will turn its focus to the Czech National Bank meeting next Thursday (04.08). It will be an important one considering it's the first led by the new board and the first in this cycle that may not yield an interest rate hike. Opinions within the Board about the need for further tightening seem to vary. In last week's interview with Hospodarske Noviny, new vice-governor, Eva Zamrazilova stated that she'd prefer rates to be stable or increase only slightly but did not want to precommit, saying that she hasn't yet decided what she'll vote for. In addition to the decision itself, we'll focus on updated economic projections and the Board's rhetoric regarding interventions.

This week we'll focus on second-quarter GDP growth data from Czechia, out Friday. Uncertainty about the data is quite high.

EUR

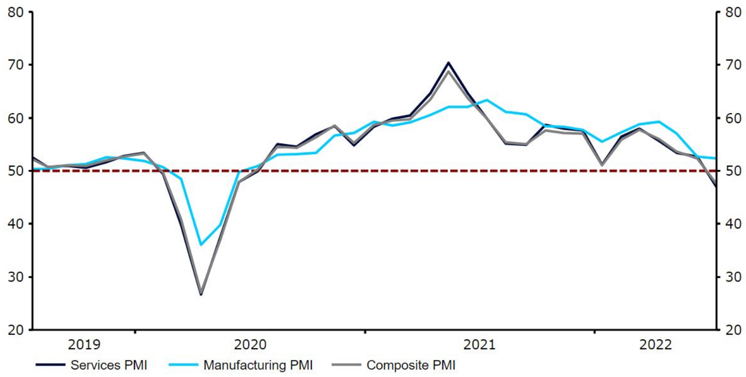
The ECB surprised markets with a 50 basis point rate hike, an event to which we had assigned a 50% probability. The initial positive reaction of the currency faded away somewhat as markets still don't feel they received enough details about the ECB's new anti-fragmentation tool. On a side note, it did away with forward guidance, part of a much needed move away from relying on its thoroughly inadequate forecasting capacity, on which we have commented often.

This uncertainty, combined with negative surprises in the PMI activity numbers, which suggest that the Eurozone economy is stagnant, capped the euro gains against the dollar and kept it hovering not far from parity. All eyes will now be on Friday's flash CPI numbers, which are expected to show that core inflation has not yet peaked in the Eurozone.

USD

There were undeniable signs of an economic slowdown in the US last week. Weekly jobless claims continue to tick up, albeit from an extremely low level. Higher mortgage rates continue to drive a housing slowdown, though housing starts remain historically high. Most worrisome in our view was the drop in the PMIs to levels consistent with outright contraction.

Figure 1: US PMIs (2019 - 2022)



Source: Refinitiv Datastream Date: 25/07/2022

While central banks worldwide have consistently surprised on the hawkish sidem, we do not expect this to be the case next week at the Federal Reserve July meeting, as signs of a US slowdown should be enough to keep its increase to 75bp. More generally, we think outsize rate increases are now a thing of the past, and we should revert to the 25 or 50 bp of the past after the July meeting, which could cap dollar gains.

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Stodolní 9 702 00 Ostrava, Czech Republic

+420 558 080 074 | info@ebury.cz | ebury.cz