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FX

FX Daily: The hawkish bar is set high for the ECB

As the ECB delivers its well-telegraphed 25bp hike, we doubt it will signal enough commitment to further tightening to validate the market's aggressively hawkish pricing. That leaves EUR/USD exposed to downside risks, particularly as the dollar may find additional support after yesterday's smaller-than-expected Treasury buyback announcement



Treasury Secretary Scott Bessent announced that the US would buy back \$6bn worth of government debt – but market expectations were clearly of a higher figure

↑ **USD: Some Bessent risk premium leaving the dollar?**

Poor price action for the dollar persisted for most of yesterday. Then came the US Treasury announcement that it would buy back \$6bn in long-term bonds, triple the amount announced in August. The bond market's negative reaction signals that expectations were clearly of a higher figure – somewhere around \$10bn had been rumoured. However, that prompted a dollar rebound, as some risk premium linked to outsized Treasury intervention was unwound.

The currency market is unlikely to shelve the debasement narrative just yet. But yesterday's announcement could help create a better environment for the dollar, potentially allowing it to respond more efficiently to external drivers such as higher oil prices and weaker equities, both

USD positives.

Today, focus will be on US PPI inflation for August, which should have a higher-than-usual market impact ahead of tomorrow's CPI and next week's FOMC. Consensus is for 0.4% MoM headline PPI, and 0.3% for core. We feel these are figures that can – if anything – slightly reinforce market conviction on a September hike: pricing is currently 16bp.

We continue to see upside risks for the dollar. If front-end USD rates remain around current levels and global sentiment stays fragile, we cannot see a fundamental reason for persistent USD underperformance. Unless inflation delivers material downside surprises today or tomorrow, the conditions appear in place for DXY to return to 99.0.

Francesco Pesole

↓ **EUR: ECB can disappoint the hawks**

EUR/USD climbed to 1.650 yesterday before reversing after the US Treasury announcement. The initial rally was driven by a sizeable 7-8bp tightening in EUR/USD two-year swap differentials, entirely the result of an almost 10bp rise in the euro leg. That likely reflected spillover from another rise in energy prices and perhaps some positioning for a hawkish ECB message today.

On the latter, we aren't convinced. As discussed in our [ECB cheat sheet](#), there are some downside risks for the euro today. Markets now price 50bp of tightening by year-end and 85bp by July, leaving the ECB with a high bar to meet. While today's widely expected 25bp hike can still be framed as an insurance move, further hikes would push policy further into restrictive territory. We doubt the ECB is ready to semi-commit to another hike by year-end, as it did in July, for two main reasons: a) the inflation projections are unlikely to justify it; b) concerns may be building around the eurozone bond market.

To be clear, we don't think the ECB will be intentionally dovish. But retaining broad optionality on further tightening seems too little to satisfy markets' hawkish bets. We expect some repricing lower in the EUR curve to pave the way for a retest of 1.160 ahead of next week's FOMC (where we expect a hike). Our one-month target remains 1.150.

Francesco Pesole

↓ **CEE: Central banks leave room for weaker zloty and koruna**

As expected, the National Bank of Poland kept rates unchanged at 3.75% yesterday. The statement offered little new guidance, leaving attention on Governor Adam Glapinski's press conference today at 3pm local time. We expect a somewhat more hawkish tone than in July, reflecting higher inflation and a firmer outlook. However, with markets pricing in around 85bp of tightening, the bar for a hawkish surprise is high. We therefore see scope for some easing in

rate expectations and a rise in EUR/PLN, also supported by record gas prices, potentially taking the pair back above 4.320.

In the Czech Republic, the CNB blackout period begins today. Deputy Governor Eva Zamrazilova, one of the board's most hawkish members, said yesterday that she favours keeping rates unchanged at next week's September meeting, strongly signalling the likely outcome for the broader board. The CNB could still communicate today, but surprises appear unlikely. Despite the ongoing rates sell-off, the interest-rate differential has narrowed and, in line with our Monday call, EUR/CZK has moved back above 24.250. The pair is currently consistent with the rates move in our models, although a more dovish CNB decision than markets expect next week could push it higher.

Frantisek Taborsky

TRY: Rates on hold but cuts ahead

We expect the CBT to keep rates unchanged at 37% today. It is too early to resume easing after the bank restarted weekly repo auctions and brought the effective funding rate down from 40% to the policy rate. Still, weaker-than-expected 2Q GDP and a continued gradual decline in inflation should allow two 100bp cuts to 35% in Q4.

As liquidity conditions have normalised, market pricing has turned more dovish and moved closer to our year-end forecast. The CBT rate is now priced at 34.50% by year-end. However, markets remain sceptical about the scope for easing next year, pricing only around 100bp of cuts. Continued disinflation could drive further dovish repricing in this part of the curve.

The FX outlook is broadly unchanged. Long TRY positioning has already returned to pre-US-Iran conflict levels, despite the CBT's dovish August stance and the prospect of renewed easing. At the same time, the continued recovery in central bank FX reserves should support investor demand for the TRY carry trade. We forecast USD/TRY at 52 by year-end and 63 by the end of next year.

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