HSBC Global Research

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# FX Market – July 2022

## What you may have missed last month

**Free to View**
Currencies - Global

**Paul Mackel**
**Global Head of FX Research**
The Hongkong and Shanghai Banking Corporation Limited

**Daragh Maher**
**Head of Research, Americas/Head of FX Strategy, US**
HSBC Securities (USA) Inc.

**Dominic Bunning**
**Head of European FX Research**
HSBC Bank plc

**Charlotte Ong**
**European FX Strategist**
HSBC Bank plc

## Main Events

- The ECB surprises the market with a 50bp hike
- EUR-USD hits parity for the first time since 2002
- The Fed hikes 75bp; Powell says "We are now in line with our estimates of neutral rate"

**Key Dates:**

| | |
|---|---|
| July 5 | The Reserve Bank of Australia (RBA) hikes by 50bp to 1.35%, in line with expectations; AUD-USD falls 0.9% |
| July 7 | UK Prime Minister Boris Johnson resigns; GBP-USD jumps 0.8% |
| July 8 | US June nonfarm payrolls beat expectations (372k vs 265k consensus); the US Dollar Index (DXY) unchanged |
| July 12 | EUR-USD hits parity for the first time since 2002 |
| July 13 | The Reserve Bank of New Zealand (RBNZ) hikes by 50bp to 2.50%; NZD-USD remains flat |
| July 13 | The Bank of Canada (BoC) hikes by 100bp vs 75bp expected; USD-CAD slides 0.4% |
| July 13 | US June CPI rises 9.1% from a year ago, higher than the 8.8% expected |
| July 19 | Reuters report suggests the European Central Bank (ECB) considering a 50bp hike; EUR-USD rallies over 1%, closes back above 1.02 |
| July 21 | The ECB hikes 50bp vs expectations for 25bp and announces more details on its new Transmission Protection Instrument (TPI); EUR-USD up 0.5% |
| July 21 | Nord Stream 1 reopens at 40% of the pipeline's overall capacity |
| July 26 | EU energy ministers agree on reducing gas usage amid fears of Russian gas export embargo |
| July 27 | The Federal Reserve (Fed) hikes 75bp, in line with expectations; Fed Chair Jerome Powell states that the central bank will be data-dependent going forward; DXY falls 0.7% |
| July 28 | US Q2 annualised GDP contracts 0.9% from a quarter ago in advance print versus a 0.4% expected increase; DXY down 0.1% |
| July 29 | Eurozone Q2 GDP rises 0.7% from a quarter ago, higher than forecasts for 0.2%; Eurozone July CPI increases 8.9% from a year ago, beats consensus expectations of 8.7% |

## Summary: USD rollover

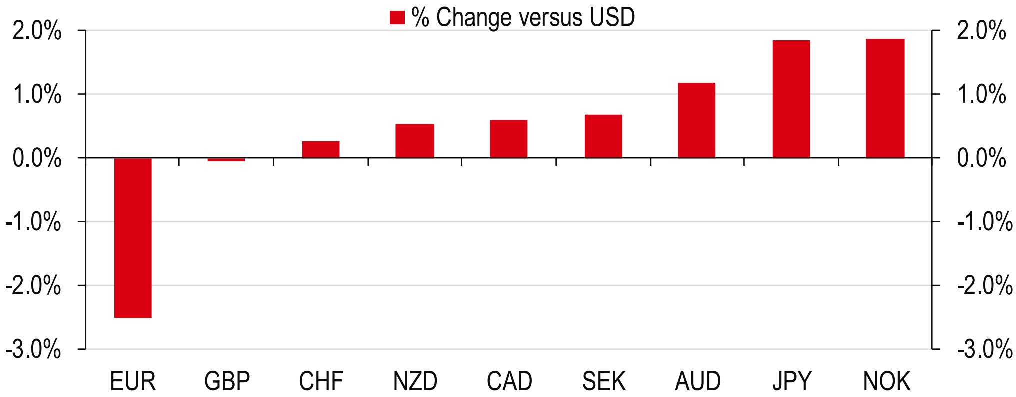
The US Dollar Index (DXY) gained 1.2%[1] in July after reversing nearly all of the gains made in the first half of the month, although these gains were concentrated against the EUR. Early in the month, an acceleration in US June CPI to 9.1% from a year ago allowed the USD to outperform as speculation about a possible 100bp hike intensified. Risk aversion and fears about a global recession also increased demand for the "safe haven" USD. However, the second half of the month saw US yields fall, removing some support for the USD. The Federal Reserve (Fed) Chair Powell's comments during the Federal Open Market Committee (FOMC) press conference on 27 July were interpreted as dovish, leading to further USD weakness.

The EUR was the worst performing G10 currency in July, with EUR-USD falling 2.5% as political uncertainty, the gas crisis, and disappointing economic data pressured the pair lower. That said, the EUR reversed some losses into month end after the European Central Bank's (ECB) unexpected 50bp hike on 21 July, despite falling versus the USD during the ECB's post-decision press conference, as the market showed scepticism about the Transmission Protection Instrument (TPI), a new bond purchase scheme aimed at helping more indebted eurozone countries and preventing financial fragmentation within the currency bloc.

The GBP closed the month basically flat against the USD. The GBP was negatively impacted by "risk-off" sentiment at the beginning of July, while worse-than-expected economic data also weighed on the currency. The GBP started its recovery on 18 July following better-than-expected employment data, and completed its rapid upturn on 27 July after Fed Chair Powell refused to push back against expectations for easier policy next year, with GBP-USD surging 1.1% to fresh monthly highs.

**Elsewhere: JPY bottoms out, global yields decline**
USD-JPY hit levels not seen since 1998 as recession fears and an ongoing Bank of Japan (BoJ) commitment to a loose monetary policy pushed the currency pair higher at the beginning of July; however, the JPY saw a rapid reversal as the month progressed as US rates headed lower and risks of a global recession intensified. The last two trading sessions of the month were crucial for the JPY to close the month as the second top performer against the USD. On 28 July, the day after the FOMC meeting and following a second consecutive contraction in US GDP, USD-JPY fell 1.7%. US 10-year Treasury yields dropped to around 2.70% on the day, wrapping up the largest monthly decline in the 10-year yield since March 2020.

**July G10 FX performance**




Source: HSBC, Bloomberg

[1] This report uses Bloomberg prices and news (unless otherwise specified).

**US: Caught between the Fed and a recession**

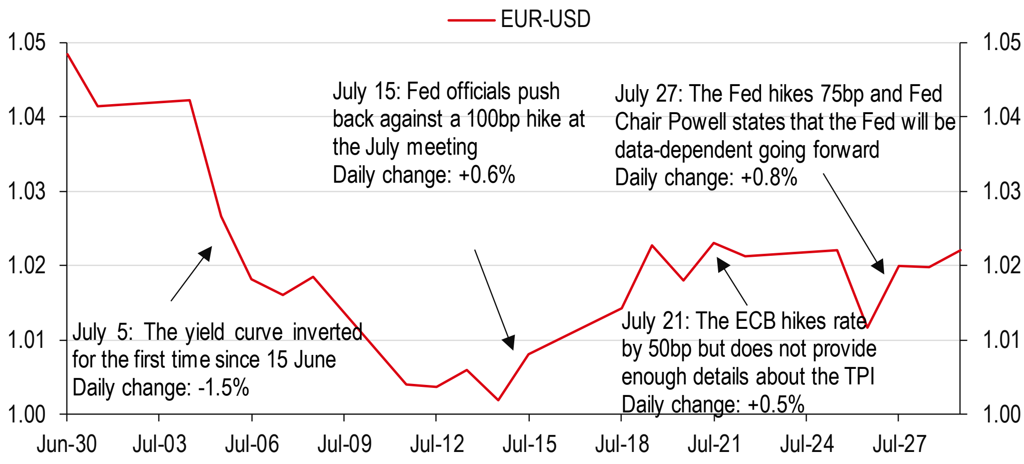
Although the first half of July saw the USD continue its seemingly unstoppable rally, the USD's momentum faltered in the second half as US yields dropped amid weaker US data and the Fed offering less obviously hawkish forward guidance. Even though the USD softened in the aftermath of the Fed meeting on 27 July and weaker-than-expected Q2 GDP data on 28 July, the DXY still managed to gain 1.5% for the whole of the month.

The start of July saw the USD continue to move higher. The DXY rose 1.3% on 5 July as the markets' bid for "safe haven" assets remained potent and the yield curve inverted (where a long-term debt instrument has a lower yield than a short-term debt instrument of the same credit quality, reflecting bond markets' expectations for a decline in long-term interest rates, typically associated with recessions) for the first time since 15 June. The downward pressure on US Treasury yields on the day did little to dent appetite for the greenback as yields in Europe and elsewhere tumbled even more. On 13 July, US June CPI rose 9.1% from a year ago, exceeding expectations for an 8.8% increase. Markets started to price in a small possibility that the FOMC may hike 100bp in July, especially after Atlanta Fed President, Raphael Bostic, stated that "everything is in play" for monetary policy (*Bloomberg*, 13 July). That said, the DXY ultimately weakened 0.1% on the day as US President Joe Biden called the inflation print "out-of-date" in a statement (*Reuters*, 13 July).

15 July proved to be the turning point for the USD as Fed officials pushed back against a 100bp hike at the July meeting. In particular, one of the more hawkish Fed members, St. Louis Fed President James Bullard, noted that the decision was mostly "50 versus 75 at this meeting". Markets paid less attention to a strong retail sales print and put more emphasis on a further dip in University of Michigan consumer sentiment and inflation expectations in July. Further weak US data followed, including various regional surveys and housing data, causing markets to dial down the probability of a 100bp hike and taking some froth out of the USD.

On 27 July, the Fed hiked interest rates by 75bp, in line with expectations. During the press conference, Fed Chair Powell did not push back against the possibility of a 75bp hike in September but added that the decision would be data-dependent and policy would be set on a meeting-by-meeting basis. Fed Chair Powell also stated that he did not believe the US was in a recession, citing a strong labour market as evidence. That said, markets perceived Powell's tone as somewhat dovish and the DXY closed the trading session 0.7% lower with all "risk-on" assets jumping higher on the day. The DXY extended its losses in the next two days after a worse-than-expected US GDP reading (-0.9% vs 0.4% consensus) pushed US yields even lower as the month came to an end.

**EUR-USD**




Source: HSBC, Bloomberg

**Eurozone: Lack of energy**

The EUR slid 2.5% against the USD in July as political uncertainty, the gas crisis, and disappointing economic data pressured the pair lower.

EUR-USD fell 0.7% on 1 July despite a slightly above-consensus print on Eurozone inflation (8.6% versus 8.5% expectations), as core inflation slowed unexpectedly to 3.7% on a year-on-year basis in June from 3.9%. The EUR fell 1.5% against the USD on 5 July after Germany reported its first monthly trade deficit since 1991 the previous day. Ongoing concerns about Europe's growth outlook continued to weigh on the currency, with a further big move on 11 July. EUR-USD dropped 1.4% as the risk of energy restrictions in Europe raised fears of weaker Eurozone growth. On 12 July, EUR-USD broke briefly below parity for the first time since 2002 as rising energy prices and political instability in Italy also weighed on the EUR.

The second half of the month saw the EUR recovering some of its losses against the USD despite the uncertainty in Italian politics caused by Italian Prime Minister Mario Draghi's resignation, which pushed Italian bond yields higher. Most of the focus was on the ECB's 21 July meeting where the first rate hike in 11 years was hotly anticipated.

The EUR extended its squeeze higher on 19 July, boosted by reports that the ECB might be weighing up a 50bp hike (*Reuters*, 19 July). On 21 July, the ECB hiked rates by 50bp with ECB President Christine Lagarde indicating that the central bank would take a data-dependent approach going forward. The EUR jumped higher in the wake of the rate announcement but slumped during the press conference as ECB President Lagarde provided only limited details about Transmission Protection Instrument (TPI), a new tool aimed at curbing excessive spread widening of peripheral bond yields. EUR-USD gained only 0.3% on the day.

The EUR then slid 1.0% on 26 July as EU energy ministers agreed on reducing gas usage amid fears of a Russian gas export embargo. The next day, the EUR took advantage of a weak USD, rising 0.8% after the FOMC meeting. EUR-USD reversed some of those gains on 29 July despite an upside surprise in Eurozone Q2 GDP (0.7% vs 0.2% consensus) and a July CPI reading of an 8.9% increase from a year ago, against 8.7% expectations.

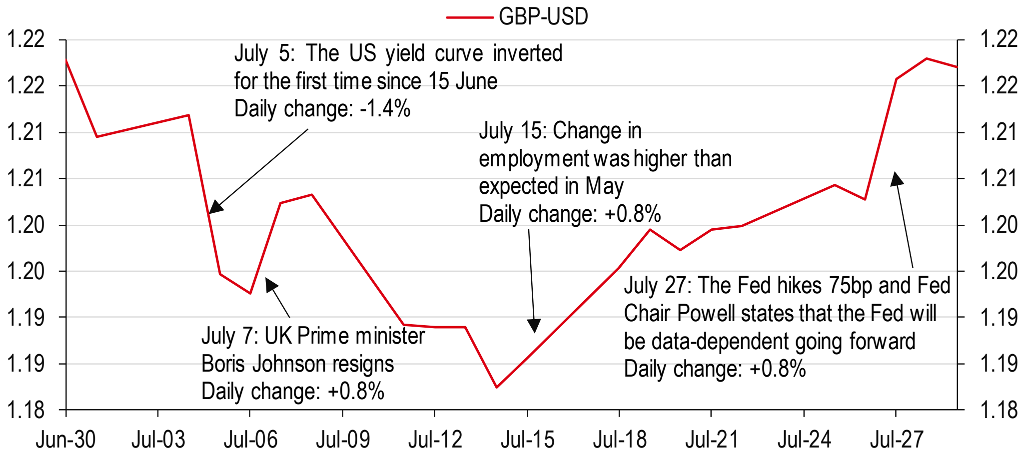
**UK: Right back where it started**

Poor risk appetite weighed on markets in the first half of July, with the GBP weakening, given its "risk-on" personality and further signs of weakness in the local data pulse. That said, the GBP was able to pare most of its losses, closing the month only 0.1% lower against the USD.

The "risk-off" sentiment at the beginning of July weighed on the GBP, with the currency falling 0.7% against the USD on 1 July. Local data also hurt the GBP, as the manufacturing PMI for June was revised lower to 52.8 from the flash estimate of 53.4. The currency saw little reprieve as the month progressed, falling a further 1.4% against the USD on 5 July and testing the support at 1.20. UK political "turmoil" caused by the resignation of multiple members of the government did not provoke much interest in FX on 6 July. However, the GBP rallied 0.8% against the USD the next day after UK Prime Minister Boris Johnson announced his resignation. The more upbeat mood in global risk appetite also contributed to the upside on the day. That said, the GBP continued to feel the effects of the strong USD falling 1.2% on 11 July.

The GBP then traded sideways until 18 July, when it gained 0.8% versus a weaker USD as the change in employment in May was higher than expected (296k versus 170k consensus), with UK workers joining the jobs market at the fastest pace since before the pandemic. However, a slightly higher-than-expected CPI reading (9.4% on a year-on-year basis vs expectations of 9.3%), failed to provide support for the GBP, which fell 0.2% on 20 July.

**GBP-USD**



Source: Bloomberg, HSBC

**China: Tug of war**

July saw the CNY both buoyed by positive domestic developments and weighed down by worsening risk sentiment, with USD-CNY ultimately ending the month up 0.7%. The economic picture painted by data releases generally pointed towards recovery. For instance, both the Caixin manufacturing and services PMIs came in higher than expected, and retail sales proved resilient, growing 3.1% on a year-on-year basis in June compared to the consensus of a 0.3% increase. On 15 July, the Q2 GDP release missed the mark with a meagre expansion of 0.4% from a year ago, compared to an expected 1.2% increase. That said, USD-CNY was unmoved on the day, with much of the growth drag attributed to the lockdowns in April and May rather than structural headwinds.

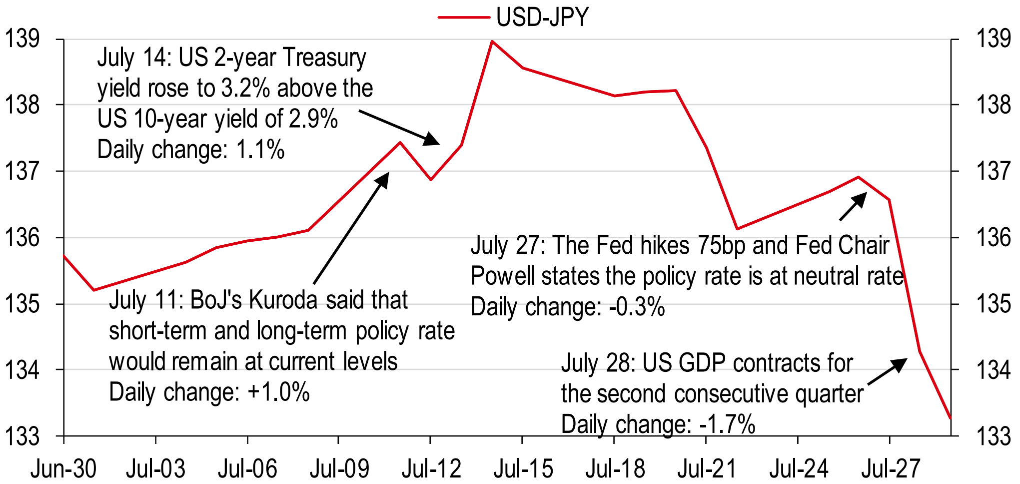
While the domestic outlook appeared supportive for the CNY, rising geopolitical tensions stifled the positive momentum for the currency. On 18 July, China issued a statement citing its opposition to the US's arms sale to Taiwan (*Bloomberg*, 18 July), with USD-CNY rising 0.2% on the day. Further headlines around US house speaker Nancy Pelosi's possible visit to Taiwan (*Bloomberg*, 27 July) added to the tensions. The call held between US President Joe Biden and Chinese President Xi Jinping on 28 July had, however, little effect on USD-CNY.

**Japan: The last-minute sprint**

USD-JPY fell 1.9% in July, as global recession fears and lower US yields both dragged the pair lower even after a move higher early in the month. On 11 July, BoJ Governor Kuroda said that short-term and long-term policy rate targets would remain at current or lower levels, despite expectations for inflation to accelerate (*Bloomberg*, 11 July). The divergence between the dovish BoJ and the hawkish Fed kept USD-JPY elevated. USD-JPY jumped 1.1% to 138.7 on 14 July as the US 2-year Treasury yield rose to 3.2%. Japan's Chief Cabinet Secretary Hirokazu Matsuno showed concern about the rapid JPY weakening and stated that the BoJ will watch the FX market more closely (*Reuters*, 14 July).

The BoJ left policy and guidance unchanged on 21 July, reinforcing its position as a policy outlier. Inflation projections were revised up, but BoJ Governor Kuroda was clear about the policy outlook, stating that the BoJ has no intention of raising interest rates (*Bloomberg*, 21 July). However, USD-JPY closed the day 0.6% lower as US Treasury yields and oil prices fell after the ECB hiked by 50bp. This set the stage for a substantial move lower in USD-JPY into month end. The JPY gained 1.7% against the USD on 28 July as Fed Chair Powell's comments during the FOMC conference were interpreted as dovish by the market and US yields fell. A contraction in US GDP for a second consecutive quarter dragged US yields lower again and pulled USD-JPY back below where it started July.

**USD-JPY**




Source: HSBC, Bloomberg

### Canada: A turn of tides

USD-CAD fell modestly, down 0.6% by the end of the month. However, this belied the CAD's comeback against the wave of broader USD strength. The CAD started the month on the defensive, with USD-CAD surging 1.3% higher on 5 July as risk aversion rippled throughout markets. On 13 July, the Bank of Canada (BoC) hiked rates by 100bp, surprising markets, which were looking for a 75bp hike, but USD-CAD only dropped 0.4% on the day. During the press conference, BoC Governor Tiff Macklem described the decision as one meant to "*front-load the path to higher interest rates*", while also admitting that the path to a soft landing was getting narrower (Bloomberg, 13 July), which limited the benefit to the CAD.

However, the latter half of the month brought about a turn of tides for the beleaguered currency. A rally in oil prices in the middle of the month triggered a decline in USD-CAD, which fell as much as 0.8% on 19 July. The CAD managed to seize the opportunity and gained further ground against the USD amidst stabilising oil prices and a dovish interpretation of the Fed into month end. On the economic front, May data were generally positive, with retail sales increasing 2.2% from a month ago against 1.6% and a higher-than-expected monthly GDP reading (+5.6% on a year-on-year basis versus +5.4% consensus). Price pressures continued to persist in June; although CPI rose by a lower-than-expected 8.1% from a year ago, wage growth on a year-on-year basis accelerated to 5.6%.

### New Zealand and Australia: Rising on risk

The AUD and the NZD both recovered versus the USD in July, the former rising 1.2% and the latter 0.5% against the USD, after bottoming out on 14 July. The main driver was risk sentiment, which improved in the second half of the month alongside lower US yields.

The Reserve Bank of Australia (RBA) hiked rates by 50bp to 1.35% at its 5 July meeting, with the minutes seeing the current policy rate "*well below*" the neutral rate. Despite that somewhat hawkish outcome, AUD-USD fell 0.9% on broader USD strength. A strong Australian labour market report on 14 July did not prompt a major FX reaction, even as the unemployment rate fell to 3.5% (consensus: 3.8%). However, the AUD jumped 0.6% the next day on the news that

China was considering lifting the ban on Australian coal, given supply concerns over Russian coal (*Reuters*, 14 July). The recovery phase continued on 19 July, with the AUD rising 1.3% against the USD after a general risk on sentiment hit the market. Although AUD-USD was 0.8% higher on 27 July, the AUD gains were limited by a lower-than-expected CPI reading (+6.1% on a year-on-year basis versus +6.3% consensus).

NZD-USD dropped 1.3% on 11 July as risk aversion continued to boost the USD and put pressure on "risk-on" currencies. The NZD was flat on 13 July following the Reserve Bank of New Zealand's (RBNZ) third consecutive 50bp rate hike, in line with consensus expectations. A new 32-year high for headline inflation and a record high for core inflation on 17 July built expectations for possible larger hikes from the RBNZ, but ultimately the NZD failed to hold onto its gains despite the "risk-on" mood in global equity markets and weaker USD. Despite broadly rallying in the second half of July, the NZD did not show the same strength as other G10 currencies against the USD. For example, NZD-USD only rose 0.5% following the Fed meeting on 27 July.

**Norway and Sweden: Slow and steady wins the race**

Despite lower oil prices, the NOK managed to gain 1.8% against the USD. The NOK started the month on the front foot, with EUR-NOK falling 1.3% on 4 July, as oil rallied on supply concerns. That said, the NOK gave up some of its gains just a day later as recession fears grew and Brent prices slid 9.5%. The NOK slipped again on 12 July, with EUR-NOK rising 0.4% on the day, as oil prices fell a further 7% on concerns around slowing demand. However, these were but minor obstacles for the NOK, with EUR-NOK surely but steadily edging lower through the rest of the month. Economic data continued to point to rising price pressures, with June CPI rising 6.3% from a year ago, compared to the expected 5.9%, a tight labour market, and some softness in the economy; May GDP for mainland Norway contracted 0.2% from a month ago versus the consensus for a 0.5% gain.

The SEK was less impressive and rose 0.7% against the USD. This was in spite of the hawkish Riksbank minutes published on 11 July for the 29 June meeting. In the minutes, Riksbank Governor Stefan Ingves commented that he was "*not sure*" that a 2% interest rate was enough to bring inflation down to target and noted that "*more hikes are reasonable*", if that was necessary to achieve the inflation target. Additionally, Riksbank Executive Board member Henry Ohlsson, voiced support for a 75bp hike. EUR-SEK fell a mere 0.3% on the day. On 14 July, inflation surged higher with June CPIF rising 8.5% from a year ago, compared to expectations for an 8.1% increase. However, even as the high inflation print stoked expectations of a possible larger hike next month, EUR-SEK weakened 0.1%.

**Oil: Fearing a global recession**

Oil prices fell 4.2% in July (Brent crude) as concerns of a global recession intensified. The bulk of the gains triggered by Russia's invasion of Ukraine were reversed, with central banks hiking rates to tame inflation and, therefore, increasing fears of a slowdown that will negatively impact demand for commodities, including energy. Global recession fears intensified on 5 July, with Brent falling 9.5% on the day. Oil extended its losses the next day, dropping below USD100 per barrel for the first time since 25 April as fears of an economic slowdown outweighed persistent supply disruptions and market tightness. Months of dwindling liquidity, alongside technical selling, and some producer hedging contributed to the slide. Brent fell another 7.1% on 12 July despite China's exports expanding at a faster pace than expected in June as COVID-19 disruptions continued to ease. The drop took place after a higher-than-expected US CPI release that put pressure on the Fed for another large hike at the July meeting. Brent recovered part of the losses in the second half of the month following a "risk-on" market sentiment and USD weakness. Oil prices reacted positively after the Fed meeting on 27 July, surging 2.1% as risk sentiment improved and tightness in supply outweighed risks to demand.

**Gold: Turning of the screw**

Gold slumped 2.3% in July as the USD rally continued. However, the trend reversed somewhat in the latter part of the month as a weaker USD and a more dovish Fed helped bullion to recover some of its losses.

Gold fell 2.4% below USD1,800 per ounce on recession fears and USD strength on 5 July. General economic pessimism also pressured gold as PMIs weakened in Europe. US Treasury yields fell, but it was more the US yield curve inversion and growing concerns of a "hard landing" that took gold below USD1,800 per ounce. There was also a strong technical component to gold's decline. The 50-day moving average crossed below the 200-day moving average, triggering heavy sell-stops. Gold fell 1.5% on 6 July as the USD remained robust and the yield curve stayed inverted. In addition, gold exchange traded funds continued to liquidate. That said, gold moved lower initially after a higher-than-expected US CPI on 13 July. However, it snapped back and rose 0.6% as the USD and yields shed all of their early gains and dropped even further.

USD strength pressed gold lower 1.5% despite sluggish US yields on 14 July. The market continued to ruminate over comments made the previous day by Atlanta Fed President Raphael Bostic that a 100bp rate hike at the next FOMC was a possibility. 21 July represented the turning point for gold, which initially hit a near 16-month low at USD1,680 per ounce but then bounced back above USD1,700 per ounce at end of the trading session. USD weakness allowed gold to rise 1.0% on 27 July, following less-hawkish-than-expected comments by Fed Chair Powell.

### Movers in July vs USD

| | | | |
|---|---|---|---|
| NOK | +1.9 % | EUR | - 2.5% |
| JPY | +1.9 % | | |

### Upcoming key events

| Date | Event |
|---|---|
| 2 August | Reserve Bank of Australia rate announcement |
| 4 August | Bank of England rate announcement |
| 10 August | US CPI for July |
| 17 August | Reserve Bank of New Zealand rate announcement |
| 18 August | Norges Bank rate announcement |

### Commodities

| | |
|---|---|
| Gold | - 4.2% |
| Brent Crude Oil | - 2.3% |

Source: Bloomberg

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