Currency Insight

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September 6th, 2022

ECB ready to take the big leap?

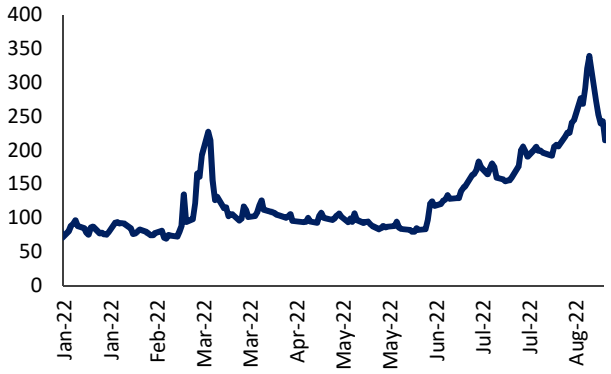
Euro hit a fresh 20-year low and fell below parity following fear of tighter monetary policy and as energy crisis in the Europe darkened market sentiment. Energy prices have driven euro-area inflation to a record 8.9% in July, making everything from groceries to utility bills more expensive. More than anything, high energy prices and record inflation are to blame. Europe is far more dependent on Russian oil and natural gas than the U.S. to keep industry humming and generate electricity. Fears that the war in Ukraine will lead to a loss of Russian oil on global markets have pushed oil prices higher. From the US, minutes from the Fed's July monetary policy meeting — at which it raised its main interest rate 0.75 percentage points to a target range of 2.25 to 2.5% — showed that policymakers discussed keeping rates at levels that would restrict the US economy. So, Euro as a currency has been hit with a double whammy following broader strength in the dollar and Energy crisis in the Euro zone.

Energy crisis worsens

Soaring energy prices are fueling inflation and adding a lot of burden on households and industries across Europe. Energy prices in Europe have been smashing records after Russia's Gazprom said that it would halt all deliveries via Nord Stream to Germany for three days between August 31 and September 2. This announcement raised renewed concerns that supply via the pipeline could be further cut or halted altogether after the three-day unplanned maintenance.

The EU will convene an emergency meeting of energy ministers as gas prices spiral higher, hitting an all-time European high on Friday and threatening to send the region's econo my into a deep recession. In July, EU ministers agreed to a voluntary reduction in national gas demand of 15% between August and March, a target that could be made mandatory if the crisis becomes more acute over winter. Gas is in short supply since Russia slashed exports to Europe on the key Nord Stream 1 pipeline in June. Industry may also face rationing in winter once the weather turns cold.

TTF Monthly Energy Future (€)



Source: Reuters

French President Emmanuel Macron, meanwhile, dropped a bomb in his first speech after the government's summer break, saying France has come to the end of the "era of abundance," warning that hard times were ahead and blaming them on climate change and Russian President. In Germany, droughts interfered with oil and coal supply to utilities as the level of the Rhine remained too low for many vessels to reach the storage sites and power plants where the coal and oil will be needed this autumn and winter. It looks like the age of abundance that much of Europe had enjoyed for a couple of generations is coming to an end.

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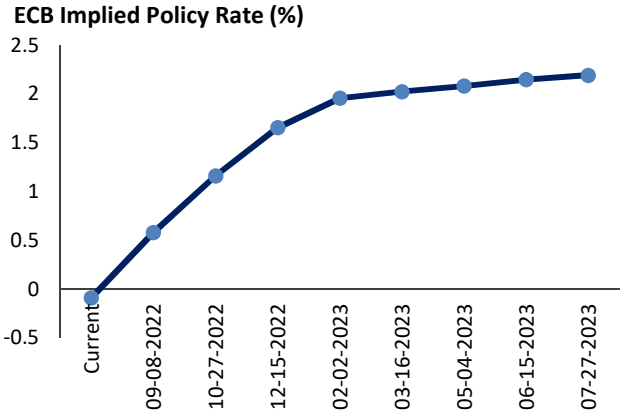
What to expect from ECB?

European Central Bank members are expected to talk up front-loadi ng rate hikes, but market participants suggest there is still doubt over whether the ECB will be able to curb inflation and that could keep the dollar bulls alive. The odds of the European Central Bank hiking rates by 75 basis points on Sept. 8, jumped to over 60%. But some remain unconvinced and question whether the front-loading of rate hikes will be enough to convince investors that the ECB will do what is necessary to fight inflation as the central bank is well behind the curve.

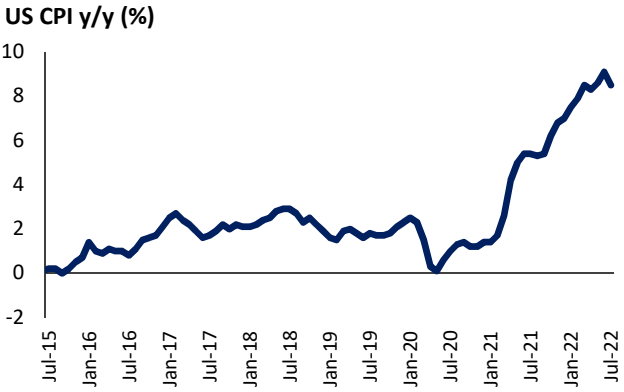


Source: Bloomberg

The ECB could also announce measures to reduce a multibillion bonanza it is set to give to banks from its ultra-cheap lending scheme known as the targeted longer term refinancing operations(LTRO). The euro has fallen to near par with the dollar — pushing up inflation further through higher prices of imports, especially energy. Minutes published for the previous meeting showed concerns about soaring inflation seemed to outweigh worries about a weakening growth outlook at the meeting in July of the ECB governing council.

Weakness led by more strength in the dollar

The hawkish Fed outlook is also weighing on the Euro and Fed Chairman's statement at the Jackson Hole Symposium cemented his unconditional commitment to tackle high inflation. Powell said the Fed will raise rates as high as needed to restrict growth, and would keep them there "for some time" to bring down inflation that is running at more than three times the Fed's 2% goal. He added that people should not expect the Fed to dial back its monetary policy quickly until the inflation problem is fixed. Dollar is close to a 20-year high after data released from the US showed the economy added 315,000 jobs in August as compared to estimates of 300,000 job addition. But hawkish remarks from Secretary of Treasury Janet Yellen on Friday after the jobs data, where she was quoted as saying that U.S. inflation remained too high and that it is the Fed's job to bring it down, dampened the initial euphoria. Inflation seems to be the major concern for the Fed and the central bank governor together with its officials have been putting his stance. The Fed is trying to keep the market apprised of what is coming in the future and the intensity of moment requires a more grounded approach.



Source: Reuters

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Outlook

Considering the rally in dollar across the board and the Euro Zone economy facing energy crisis we expect that the EURUSD pair to remain under pressure. All focus will be on this week's ECB meeting and any hawkish comments could restrict sharp downside but escalating energy crisis could continue to cap rallies. Apart from ECB policy statement, market participants will also be keeping an eye on the EU energy ministers meeting that is scheduled later this week to discuss measures to tame spiraling natural gas prices. While the rise in gas prices could worsen the inflation situation, it also darkens the outlook for economic growth.

Technically, the EURUSD pair is expected to trade with a negative bias and it is likely to face resistance in the zone of 1.0080 and 1.0150 and on the downside the pair could find support in the zone of 0.9750 and 0.9600.

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