Daily FX: Real yield story survives the week

The University of Michigan 5-10-year inflation expectations will attract more interest than usual today, particularly if they challenge the recent highs of 2.7% - feeding into the view that inflation will rise and while the Fed does nothing, declining real yields sink the dollar

Source: Shutterstock

USD: Inflation expectations will be of greater interest today

US equity markets have survived this week's sell-off in US Treasuries and presumably are being influenced by President Trump's offer of a capital gains tax cut – if he's re-elected. The Senate is now in recess until Labor Day (7 September), thus the prospects of a new stimulus deal over coming weeks look low. However, the need for a new package seems less urgent in that US data seems to support the V priced into cyclical assets.

Here weekly initial claims have now fallen below 1m and today's July retail sales is seen rising 2% MoM. This may be the last of the good data before a deteriorating trend is seen into September. Earlier in the week, we had thought rising nominal Treasury yields could have been the catalyst for a corrective rally in the dollar. That rally never took place and it seems investors have sunk their teeth into the negative real yield story.

US inflation expectations derived through TIPS and the 5-year forward inflation swap are on their highs and later today we see the University of Michigan 5-10-year inflation expectations. These may attract more interest than usual if they challenge the recent high of 2.7% - feeding into the view that inflation will rise and while the Fed does nothing, declining real yields sink the dollar. DXY price action has been soft this week. DXY could easily slip to 92.50.

EUR: Focus on GDP revisions

EUR/USD price action has been strong – a function of the soft dollar.

Today we'll see if 2Q20 Eurozone GDP is revised from -12% QoQ. EUR/$ could trade a 1.18-1.19 range in quiet markets. Poland has its first look at 2Q20 GDP today. A 9% QoQ contraction is expected. A better outcome could see EUR/PLN press 4.37.

GBP: Brexit talk hopes having little impact

GBP showed little reaction yesterday to optimistic UK tweets over the next round of UK-EU trade talks.

EUR/GBP should stay bid, as should Cable.

MXN: Banxico cuts 50bp as expected

Last night Mexico's central bank cut the policy rate 50 basis points to 4.50% as expected.

As Gustavo Rangel highlighted in his preview, Mexico looks set to suffer the largest contraction in Latin America this year (-10%), but Banxico is mindful of inflation and also the risk of de-stabilising bond outflows if rates are cut too far. Thus, it looks as though Banxico may be getting close to the end of the easing cycle. That said, the market prices a further 75bp of a rate cut over the next six months and we think that some more easing in September cannot be ruled out.

With rates around 4%, however, MXN is one of the few currencies offering much nominal carry these days. And with the Fed still minded to add more liquidity and the USD under pressure, we think USD/MXN trades in the low 22s next six months.

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