Daily FX Strategy: Good UK data no help to battered sterling

UK inflation probably rose in June but confirmation of this today is unlikely to have a positive impact on sterling, as investors remain focused on Brexit

USD: Another reminder of the unpredictability of US trade policy

Although Federal Reserve Chairman Jerome Powell reiterated his message from his last week's testimony (suggesting a July rate cut), the positive spillover into emerging market FX has been hampered by President Trump's renewed threat of tariffs on China. The high degree of unpredictability of US trade policy should keep a lid on EM FX gains, making EM local currency bonds a more attractive asset class in our view. This is because both scenarios of (a) more easing from major central banks; and (b) possible escalation of trade wars should be positive for EM fixed income, while in the case of EM FX, the asset class would only do well under the former.

EUR: Few reasons to be cheerful

The soft European June car sales figures highlighted the downside risk to the eurozone growth outlook, particularly in light of the openness of the eurozone economy and its exposure to car exports. EUR/USD should continue testing the 1.1200 level today. By extension, this does not bode particularly well for the satellite central and eastern European economies exposed to (a) eurozone growth; and (b) the car industry. This is one of the key reasons why we remain negative on the overbought Czech koruna.

GBP: Positive UK data no help to battered sterling

The expected rise in both UK June headline and core CPI is unlikely to have a positive impact on sterling as it is the rising perceived probability of a hard Brexit that remains the key driver of the pound. This was very evident yesterday, when comments from the Conservative party leadership contenders weighed on GBP, with the currency looking through the very solid wage data. The rising perceived probability of a disorderly Brexit after the 31 October deadline is reflected in the options market, with the sterling implied volatility curve heavily kinked around the deadline date (that is 3-4 month tenors) vs the close-to-normally upward sloping shape of the curve two to three months ago. Sterling risk reversals also surged but are still considerably below the March highs. Expect more of the same today, with any positive UK data points playing second fiddle to Brexit.

CAD: Inflation to stay robust, BoC to stay put

The latest CFTC positioning data shows that net combined positions on the Canadian dollar have turned positive in July for the first time since 1Q18. All eyes today will be on the Canadian inflation report for June. According to a Bloomberg survey, headline CPI should decelerate, although all core measures (preferred by the Bank of Canada) should stay above the 2% target range mid-point. This should allow the BoC to stick to a neutral stance, keeping any USD/CAD rebound broadly limited. Today, we expect the pair to stay range-bound and consolidate below 1.3050.