For the euro, it's all about the growth

Since April- when the risks of a global trade war ramped up- expectations for growth in the US and eurozone have diverged and the euro has fallen about 7% against the dollar. Here's our view on what's likely to happen next

EUR: Next big move in the EZ-US growth differential will determine direction

Most of the dynamics for EUR/USD over the past 12 months can be captured by the simplicity of relative eurozone versus US economic growth outlooks (shock horror, right?). But let's put some numbers on it. Between April and October 2017, consensus expectations for 2018 US and eurozone GDP narrowed by more than 0.4 percentage points – during which time the euro gained by more than 15% against the US dollar. Since April this year – and when risks of a global trade war ramped up – the expected US-eurozone 2018 growth differential has widened by around 0.3ppts, with EUR/USD moving almost 10 big figures (~7%) lower. In effect, the median expected growth differential has gone from pricing in a narrative of economic convergence to a narrative of economic divergence – the latter occurring due to some unexpected negative demand shocks in Europe (e.g. bad weather, Italian politics and trade war risks). Going back to basics is sometimes useful to shape one's view on where things go next. Indeed, while EUR/USD may have found an interim stabilising point above the 1.15 level – to truly gauge what the next big five figure directional move will be, one needs to make an assessment on whether the median expected US-EZ growth differential diverges even further – or in fact starts to show fresh signs of converging again. The latter is the most compelling to us at this stage – with exuberant US growth expectations moderating as the cost of Trump's trade war takes its toll on the domestic economy (see our note here for more). We've flat-lined our EUR/USD forecast at 1.17 for the coming months – but we're now pretty much watching out for any clear incipient signs that shed light on which way the median US-EZ growth differential is heading.

USD: Tariffs won't fix a structural trade deficit as data will ultimately show

While it's a fairly quiet day in markets, we do get advance US trade data for the month of May today (consensus is looking for a slight widening in the deficit to $69 billion). But 2018 will continue to highlight the structural trade deficit in the US – and such structural headwinds underpin our strategically bearish US dollar view.

CZK: Czech National Bank to hike today but koruna strength will be limited

Against consensus, we expect the CNB to hike today as the CZK is significantly weaker compared to the central bank's own forecast (which in turn means that the needed tightening of monetary conditions is missing). We envisage modest CZK strength in response to a CNB hike, yet the currency's upside may be partly mitigated by the challenging environment for emerging market FX – with the entire central and eastern Europe space under pressure – while a hike is already being priced in by markets with a 60% probability. EUR/CZK unlikely to break sustainably below the 25.70 level today.

NZD: Hard to see the RBNZ turning more dovish but high-beta kiwi vulnerable

The Reserve Bank of New Zealand meeting later today is expected to be a damp squib – with the central bank not scheduled to release any new projections this month. Equally though, the pretty flat NZD OIS curve – with a mere 40bps of tightening priced in over a two-year horizon – suggests that investors aren't really expecting much action from the RBNZ anytime soon. Inflation remains the primary catalyst for officials to change course – with the focus here on the 2Q CPI report (16 July). Domestic drivers for the kiwi have been few and far between in 2018 – with the currency trading in line with global market forces. With stock markets wobbling, the bias for NZD/USD remains skewed to the downside (with one eye on the 0.68 level).

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