FX Daily: US and eurozone inflation in focus

The US releases July core PCE figures, and we are aligned with the consensus for a 0.2% MoM call, which should keep markets attached to their call for 100bp of easing by year-end. EUR/USD may remain capped on some encouraging eurozone-wide CPI figures, while hotter Tokyo inflation overnight suggests higher chances of a BoJ hike

US inflation numbers today will be watched closely for clues on future Fed easing

USD: PCE may not rock markets

The latest bunch of US data has confirmed widely established notions: the US started the summer with strong economic momentum (2Q growth was revised higher to 3.0% thanks to stronger consumption), but disinflation was equally happening at a decent pace. The core PCE revision for 2Q from 2.9% to 2.8% is encouraging and suggests we should get an even lower historical monthly profile.

Today, the core PCE figure for July is expected at 0.2% MoM, and our economist call is in line with consensus. The Fed has shifted the focus towards the employment side of its mandate on the back of greater disinflation confidence, and our view is that both the FOMC preferred measure (core PCE) and CPI data will keep building that confidence.

That said, the dollar does not appear in a position to trade much lower in the very near term. The market's conviction on Fed easing led to its own dovish tilt in communication by many weeks, and the largest chunk of the dollar decline has probably already happened. We have seen this as a consolidation week for FX, and the proximity to Monday's Labour Day holiday in the US may favour range-bound trading today despite the PCE risk event.

Elsewhere in the G10, the outperformance of NZD and AUD wasn't driven by idiosyncratic factors but may be associated with the market pricing out some of the protectionist aspects of the Trump trade. On this topic, US election opinion polls tend to be more accurate after Labour Day, and a higher FX sensitivity to Harris-Trump news appears likely. A poll published by Bloomberg/Morning Consult indicated Harris leading Trump in each of the seven swing states.

Latam currencies could, in theory, join the antipodeans at the top of the scoreboard based on external drivers, but the domestic picture continues to weigh heavily on both MXN and BRL. In Brazil, the appointment of new central bank chief Gabriel Galipolo, who is seen as aligned with President Lula's dovish views, may be contributing to the real's selloff. In the May policy decision, Galipolo had backed a larger cut (in line with Lula's call) despite inflation concerns. There is another risk event with the release of the budget in Brazil today, as well as building expectations for outflows due to rebalancing in the MSCI equity index.

Francesco Pesole

EUR: Case for sub-1.10 remains weak

Latest macro news has endorsed the readjustment lower in EUR/USD, which was probably initiated by some month-end rebalancing flow. Earlier this week, we looked at the two-year USD:EUR swap rate gap, which had shrunk to the 95bp level, and thought that it looked a little stretched in favour of the EUR. Faster-than-expected disinflation in Germany and Spain proved to be the trigger for some dovish repricing in the EUR OIS curve, and that spread has now rewidened beyond 100bp.

Year-end pricing for ECB easing is at 70bp, and markets may be waiting for the eurozone-wide CPI figure published today to make the push to the full 75bp over three meetings. That might sound slightly aggressive to some, especially when considering the ECB's cautious stance, but would mirror the dovish-leaning approach on Fed pricing, which stands at 100bp despite the Fed having given no hints of a half-point cut at any point.

Most of the focus will be on the eurozone CPI core print today, which consensus had seen declining from 2.9% to 2.8%. French inflation numbers have just been published and were a bit higher than expected, but those may be overlooked due to the impact of the Olympic Games.

We think EUR/USD can probably stay below 1.110 into the weekend. However, even with the EUR curve shifting to price in 75bp of easing by year-end, the argument for a break below 1.100 remains scarce, and we would instead favour a 1.105/1.150 range early next week.

Francesco Pesole

GBP: EUR/GBP will take time to recover

Euro weakness has led to a substantial drop in EUR/GBP over the past few days, and the pair is now close to testing the 0.8400 support. That level was briefly breached in late July but proved to be an area of decent support for the pair.

The EUR:GBP 2-year swap rate gap shifted in favour of GBP of late thanks to some hawkish repricing in the Sonia curve and markets adding ECB easing bets yesterday. It is now at -146bp, the widest since February, meaning that a rebound in EUR/GBP now requires a meaningful rebuilding in Bank of England easing expectations. That seems unlikely to happen until we get new tier-one data in the UK, as BoE officials have broadly reiterated a cautious stance on easing.

Francesco Pesole

JPY: Inflation surprise in Japan

USD/JPY did not react negatively to the inflation surprise in Japan overnight, but the release does have some relevance from a Bank of Japan perspective. Tokyo CPI for August accelerated from 2.2% to 2.6% against a consensus of 2.3%, and the core indicator from 2.2% to 2.4% versus 2.2% expectations.

We could see why there is some reluctance to chase USD/JPY lower before clarity on US core PCE and considering how much easing is already priced into the USD OIS curve. However, we think markets are still underestimating the chances of another hike by the BoJ before the end of the year, with only 8bp priced in by December.

Hawkish surprises by the BoJ remain a tangible risk for USD/JPY, and while the external picture may struggle to turn much more positive for the yen, the latest inflation figures lower the chances of another big bounce in the pair.

Francesco Pesole

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com