

## FX Daily: A softer dollar is 'on the table'

Chair Powell deliberately put the possibility of a September rate cut 'on the table' last night. Short term dollar rates are moving lower and leave the dollar subject to downside risks were US data to come in on the weak side. That risk comes from July manufacturing ISM today and tomorrow's US jobs report. Also, look out for rate cuts in the UK and Czech Republic



### 📉 USD: Short rates are on the move

As we noted in our [Federal Reserve review](#), the dollar initially rallied on the release of the new FOMC statement but then sold off when Chair Jerome Powell seemingly deliberately adopted a new script that a September rate cut 'could be on the table'. That phrase – together with the emphasis on the switch back to the central bank's dual mandate – did actually see US short rates move. US two-year Treasury yields dropped around 10bp and back to levels last seen in early February.

And importantly, the Fed's terminal rate for the expected easing cycle dropped to a new low for this decline. For example, the one-month USD OIS, priced two to three years forward, dropped back to the early February lows and undermined the emerging view that a potential Donald Trump presidency would mean a higher Fed terminal rate.

This softening in US short-dated rates should be negative for the dollar and positive for risk assets. The problem for risk assets is that geopolitical threats plus a very soft manufacturing story in Europe and Asia are hardly supporting growth-friendly currencies. Perhaps that is why the biggest beneficiaries of this softer dollar environment continue to be the Japanese yen and the Swiss franc.

On the subject of USD/JPY, positioning at the speculative level anyway will be much better balanced than it was at the start of July. We have already seen an 8% correction since the start of July (of a similar magnitude to the correction seen late last year) and we suspect it will require a lot more bad news to see the kind of disorderly correction all the way to 140 - e.g., similar to an October 1998 correction. We doubt the correction will extend that far, but acknowledge that the soft US rate environment and the threat of Trump espousing a weak dollar policy in the run-up to November will keep USD/JPY fragile. 151.60/152.00 may be the best levels USD/JPY sees now on any corrective bounce.

For today, the focus will be on soft US ISM manufacturing data, which could keep DXY biased to recent lows near 103.65.

*Chris Turner*

## ➔ EUR: Making heavy-weather of a better environment

EUR/USD should be doing better now that short-dated US rates are on the move again. The problem is that short-dated EUR interest rates are quite soft too as the market considers the European Central Bank cutting more than twice later this year. That pricing seems far too aggressive in our view and instead, we think two-year EUR swap differentials will narrow further and provide EUR/USD with a little support.

However, the European manufacturing sector remains in a general malaise – and a softer Chinese manufacturing PMI overnight doesn't help. This means that the euro is not seen as the preferred vehicle to express a bearish dollar view. It therefore looks like EUR/USD can stay supported in a 1.0800-1.0850 range for the time being, and its best hope will be some much softer than expected US data.

With US rates dropping and oil bid on Middle East tensions, the Norwegian krone might win a few more friends. Sellers of EUR/NOK could emerge in the 11.85/90 area.

*Chris Turner*

## ⬇ GBP: Let the rate cuts begin

We have held a longstanding house call that the Bank of England will cut rates today. And we're sticking to that call. The market is just about leaning towards that as well, but we think that sterling will drop if a cut is delivered. As we discuss in our [BoE preview](#), we think this cut could be worth a 10-15bp drop in ten-year Gilt yields and knock a cent off GBP/USD.

Our rationale here is, why wait? Services inflation, if you strip out volatile items, is on a clear decline and weaker pricing power is very much confirmed in the BoE Decision Maker Panel surveys. If the BoE does cut, the consensus is that it will not provide forward guidance on the path of future rate cuts. Yet in May, Governor Andrew Bailey did go as far as to say that the market was underestimating the path of future easing. Clearly, any repetition of remarks like those will see

sterling sell off some more.

For EUR/GBP, we see levels in the 0.8460/80 region should the rate cut be delivered today.

*Chris Turner*

## CEE: CNB slows pace of rate cuts

Yesterday's Fed meeting brought another wave of a rally in the core rate markets, which should have an impact on today's trading in the CEE region. EUR/USD is unlikely to hit the overall picture this time around so it will be more of a rates game on the FX side today. We remain bullish on CZK and PLN and bearish on HUF, however, due to the extent of the core rates move we are likely to see higher volatility today.

Later today, we will see the Czech National Bank decision. In line with surveys, we expect a slowdown from 50bp to 25bp rate cuts, resulting in a cut to 4.50%. The central bank will release a new forecast that should see a few changes, which we discussed in our full [CNB preview](#). However, the markets are currently pricing in a roughly 40bp rate cut and, in conjunction with the hawkish forecast revision, we therefore expect a hawkish outcome from today's meeting. This should support the short end of the curve to the upside and with it the CZK, which has moved back above 25.400 EUR/CZK under the pressure of aggressive dovish pricing in recent days. In our view, the CZK has decent potential to rally from these levels.

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