

FX Daily: Australian inflation weighs on risk assets

April's above-consensus Australian CPI print has hit the local bond market and serves as a reminder that the Reserve Bank of Australia may not be done hiking. While higher local interest rates may be seen as good news for the Australian dollar, the jury remains out on whether the Federal Reserve will be able to cut this year and what that means for the US dollar



➔ USD: Focus again on Treasury auctions

Global FX markets remain relatively quiet and the dollar is slightly stronger. Driving this strength was yesterday's surprise bounce in US May consumer confidence and also a slight tick up in US yields on the back of some soft auctions of two and five-year US Treasuries. Tonight sees \$44bn of seven-year US Treasuries auctioned. The ability of the US government to fund its debt at the same price will be a hot topic for financial markets this year, but so far higher US yields have been associated with a stronger dollar. We feel that relationship could break down at some point - but perhaps that is a story for next year. For the time being, higher US yields have dragged USD/JPY back into the 157.50/158.00 FX intervention zone. Given Japan's finite FX reserves, we suspect local authorities may save intervention (\$50bn of FX sold so far this year) until USD/JPY is closer to 160.

Two other themes are in focus today. The first is Australia's above-consensus 3.6% year-on-year CPI for April. As ING's Regional Head of Asian Research Rob Carnell [writes today](#), the high CPI print puts paid to the chances of a Reserve Bank of Australia rate cut this year. The local bond market was hit quite hard on the print, with yields rising 10-15bp across the curve. Australia's high inflation may also be a reminder that the prospects of Fed easing this year (30bp of cuts still priced) could still be wiped out. A [recent IMF blog](#) highlights that both the US and Australia are running positive output gaps in 2024 and are therefore more prone to sticky inflation.

The second theme - and probably a reason why the Australian dollar is not firmer today - is that the onshore USD/CNY has drifted close to the highs of the year. Investors are wary that this could trade through 7.2500 and spark speculation that Chinese authorities do favour a weaker currency after all. That is not ING's house view, but it is a genuine risk which would be bad for risk assets and good for the dollar. Let's see what happens to USD/CNY later this week.

Today's US data calendar is pretty light and includes Fed speakers much later in the day and the release of the Fed Beige Book ahead of the 12 June FOMC meeting. DXY held support at 104.40 yesterday. With bond yields rising around the world - including Japan - headwinds to risk assets today slightly favour DXY edging higher within a 104.40-105.00 range.

Chris Turner

➔ EUR: German CPI in focus

The highlight of the eurozone calendar this week will be Friday's release of flash eurozone CPI for May. Input into that release will be today's German CPI data, where consensus is looking for a slight uptick to 2.4% YoY from 2.2%. That will not deter the European Central Bank from a rate cut next week but may see the market continue to pare back expectations of further rate cuts this year. 58bp of ECB rate cuts are now priced for 2024 - down from 75bp just two weeks ago.

Higher global yields, softer equities and a slightly stronger dollar have sent EUR/USD a little lower. Two-year EUR:USD swap differentials suggest EUR/USD should be trading much lower and if equities soften today, EUR/USD could be retesting 1.0800.

Chris Turner

➔ GBP: Backing 0.85 support to hold in EUR/GBP

EUR/GBP continues to trade on the lows. Labour's Shadow Chancellor, Rachel Reeves, is making all the right fiscal noises - although the Labour Party may find they've boxed themselves from a policy perspective should they win July's general election. For reference, the UK's sovereign five-year credit default swap (CDS) is falling and at 25bp. The equivalent US CDS is rising and at 43bp.

While the decline in the UK CDS is welcome - and a far cry from the spike over 50bp witnessed during the brief Liz Truss government in 2022 - we think sterling will still largely trade off the interest rate story. We think the market pricing of just 33bp for Bank of England rate cuts this year is far too modest. And we think EUR/GBP will largely hold support near 0.8500.

Chris Turner

AUD: Aussie should perform well on the crosses

One might have expected the Australian dollar to be performing a little better today given the big jump in Australian interest rates. As above, it looks like the China story may be holding it back. Given our house view that China will not devalue the renminbi for competitive gains, we think the Australian dollar can outperform on the crosses - especially against Europe. We have a long-standing bearish call on EUR/AUD and we see the recent run-up in GBP/AUD from 1.90 to 1.92 being completely reversed over the next month.

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