

## FX Daily: Bank of Canada to double down on divergence

We expect a 25bp rate cut in Canada today as inflation continues to decelerate and the jobs market loosens. The move may help cement Fed cut bets further. Elsewhere, EUR/USD broke its recent range to trade lower as the dollar still seems to benefit from the Trump trade. Meanwhile, SEK and NOK are close to key levels against the euro



Governor of the Bank of Canada, Tiff Macklem

### 📉 USD: Trump trade still at work

The FX market got a little shake-up yesterday as EUR/USD broke lower from its recent flat trading. The dollar losses from the softer June CPI report have now been erased in most USD crosses, with JPY, CHF and GBP standing out as a few key winners. Looking at the bottom of the FX scorecard, we sense the Trump trade is still very much at play. Scandinavian and Antipodeans are all 2.3-3.0% weaker against the dollar since the assassination attempt of Donald Trump on 13 July, and that's despite some currency-positive news like above-consensus non-tradeable CPI in New Zealand and strong employment numbers in Australia.

Still, this appears more an adjustment to the Trump re-election risk rather than the start of a multi-month trend. The Federal Reserve story remains negative for the dollar and should ultimately put a cap to dollar gains short-term. Yesterday, a robust two-year Treasury auction drew the lowest

yields from January, and we think that a Bank of Canada cut today (more in the CAD section below) can help further cement Fed cut expectations.

Today, S&P Global PMIs are released across some developed countries including the US. That is not the highly-regarded ISM survey, but allows us to make comparisons with the eurozone and gives some direction for ISM expectations. Consensus is for softer services PMIs but stable manufacturing. It's interesting to note how this PMI survey has been steadily more optimistic than the ISM, which showed both services and manufacturing falling below the 50.0 line in June.

There is a good chance markets oversee the release though, and that the FX market defaults to focusing on domestic stories while the currencies sensitive to the Trump trade struggle to recover in the near term. The low FX volatility environment is clearly not favouring any rotation back to carry trades. On the contrary, markets appear to be unwinding positions in some selected high-yielding currencies like MXN and ZAR, while the funding JPY continues to perform very well. Given that we expect a hike from the Bank of Japan next week, we see further risks of carry-trade unwinding in the near term.

*Francesco Pesole*

## EUR: PMIs in focus

Yesterday's adjustment lower in EUR/USD is in line with the general dollar strength in G10. We'll be interested to see whether the other European pro-cyclical outperformer, GBP, follows suit with some softening – perhaps with markets taking the chances of an August Bank of England rate cut back to 50%+ after a BoC cut today. EUR/GBP looks rather cheap at 0.84 and GBP/USD rather expensive at 1.29 compared to their rate differentials.

In the eurozone and the UK, the PMIs will set the market mood today. Consensus is looking for an unchanged composite PMI at 50.9 in the eurozone and a slight improvement in the UK figures. The generally stable sentiment after the French election scare can favour a bit more optimism in the region, although structural challenges persist and business mood may struggle to improve much from here. EUR/USD can probably continue to trade in tight ranges into the next big market event – the FOMC meeting next week.

Elsewhere, we are keeping a very close eye on NOK and SEK, which have been the worst G10 performers since the assassination attempt on Trump. These are the two least liquid currencies in G10, and we suspect markets are particularly punishing this aspect and rebuilding those shorts that had been trimmed throughout May/June. Both currencies are close to key levels versus the euro.

EUR/SEK is testing the 11.70 resistance, which is where the Riksbank cut rates in May. Should it break higher, SEK may get some support from markets pricing out some Riksbank easing as they deem it inconsistent with such a weak currency. EUR/NOK is near the 12.00 mark, which was the 2023 peak. If we see a move to new post-pandemic highs, then we see Norges Bank stepping in with some sort of verbal support.

Both currencies are in very fragile positions, but we think it is more likely we have seen the peak in both EUR/SEK and EUR/NOK as opposed to a break above those key levels. After all, both currencies are already sharply undervalued, and in particular NOK can also count on an attractive yield.

Francesco Pesole

## 📌 CAD: 25bp cut by the BoC today

[We expect](#) the Bank of Canada to cut the policy rate by 25bp today. This is almost entirely priced in by markets (21bp), which currently expect a total 65bp of easing by year-end. Consensus is not unanimous, but the majority of economists call for a cut as opposed to a hold.

As discussed in our [BoC preview](#), there is a strong case from a macro perspective to continue easing after the June cut. All main measures of inflation are now within the 1-3% BoC tolerance band, with the headline and median core rates coming in lower than expected in June at 2.7% and 2.6% respectively. The jobs market has also weakened more than expected, with employment growth turning negative and unemployment rising to 6.4% in June. The BoC's own business outlook survey showed a further deterioration in the second quarter.

The only argument for keeping rates on hold at this meeting is probably the divergence with the Fed. However, markets have grown increasingly confident on a Fed cut in September, and the BoC has so far shown little concerns of decoupling with its US counterpart. We think this could be a problem moving forward if Fed communication and/or US data decreases the likelihood of a rate cut in September, which may lead the BoC to skip a September cut too.

The widening BoC-Fed gap has obvious repercussions on CAD, and there could be some concerns down the road that an excessive depreciation of the loonie raises inflationary risks. In our view, as long as USD/CAD stays under 1.40, the currency situation should remain very much secondary in the BoC's decision-making.

Markets will focus on forward-looking indications by the BoC. There is a possibility that Governor Tiff Macklem will strike a caution tone on further easing and take shelter behind a data-dependent, meeting-by-meeting approach. Still, the risks are skewed towards the downside for CAD as markets will be tempted to fully price in another two cuts by year-end. USD/CAD may find its way well into the 1.38-1.39 range in the near term, and CAD could start losing some ground against other high-beta G10 currencies.

Francesco Pesole

## 📌 HUF: NBH rate cut confirms dovish market pricing and encourages FX to weaken

The National Bank of Hungary delivered a 25bp rate cut to 6.75% yesterday, bringing it closer to its CEE peers again. While NBH communication hasn't changed much, we saw openness to rate cuts for the next meetings. However, it is clear that the inflation rebound rate in the coming months and EUR/HUF will be crucial. On the inflation side, our economists still expect rather more than the current consensus with 5.3% at the end of the year. For now, we leave [one additional rate cut](#) for this year in our forecast – but the risks here are clearly skewed in a dovish direction.

The HUF therefore has a heavy burden to bear in our view. We have been bearish here for some time, and this is mainly due to the rally in the rates market in the last three weeks and the significant tightening of the rate differential that we discussed here earlier. Yesterday's rate cut is just a confirmation for markets of the current market pricing and will be a trigger for HUF to weaken. Although summer low liquidity may bring surprises, we believe EUR/HUF will go up in the

coming days, with 394 as the first stop. In the medium term, we maintain a trading range of 385-400 EUR/HUF, which makes sense for us to keep going forward. However, in the short term, we now see a move towards the upper range due to the NBH's stance and market pricing.

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