

FX Daily: Dollar benefits from a lack of alternatives

The US remains on an encouraging disinflation track, but the dollar is not turning lower. This is, in our view, due to a lack of attractive alternatives given warning growth signals in other parts of the world (such as the eurozone and China). Evidence of a US economic slowdown is needed to bring USD substantially lower



July's benign US inflation numbers have reassured markets that there are no setbacks in the disinflationary process for now

📈 USD: Disinflation not enough for the bears

[July's US inflation numbers](#) released yesterday were largely in line with expectations, reassuring markets that there are no setbacks in the disinflationary process for now. Core inflation inched lower from 4.8% to 4.7%, while the headline rate suffered a rebound (from 3.0% to 3.2%) due to a reduced base effect compared to previous months, which was still smaller than the consensus of 3.3%. With the exception of resilience in housing prices, price pressures clearly abated across all components.

All in all, the US report offered reasons for the Fed and for risk assets to cheer, as the [chance of another rate hike declined further](#). Equities rallied and the US yield curve re-steepened: the dollar should have dropped across the board in this scenario. However, the post-CPI picture in FX was

actually more mixed. This was a testament to how currencies are not uniquely driven by US news at the moment. The Japanese yen drop was not a surprise, given abating bond and FX volatility, equity outperformance and carry-trade revamp, but FX markets seemed lightly impacted by CPI figures and the subsequent risk-on environment, as many high-beta currencies failed to hang on to gains.

From a dollar point of view, we think the recent price action denotes a reluctance to rotate away from the greenback given the emergence of concerning stories in other parts of the world. This is not to say that the activity outlook in the US is particularly bright – jobless claims touched a one-month high yesterday, and the outlook remains very vulnerable to deteriorated credit dynamics – but if economic slowdown alarms are flashing yellow in Washington, they are flashing amber in Frankfurt and Beijing. Chinese real estate developer Garden reported a record net loss of up to \$7.6bn during the first half of the year yesterday, at a time when China's officials are trying to calm investors' nerves about another potential property crisis.

Back to the US, PPI and the University of Michigan inflation expectation figures out today will clarify how far the disinflation story has gone in July, but we still sense a substantial dollar decline is not on the cards for the moment, or at least until compelling evidence of slowing US activity makes the prospect of Fed cuts less remote. DXY may consolidate above 102.00 over the next few days.

Francesco Pesole

📉 EUR: Range-bound for now

The EUR-USD two-year swap rate gap tightened for a third consecutive session yesterday, although by quite negligible amounts (-146bp to -140bp) compared to the massive rewidening experienced throughout July (where it had reached a -100bp peak).

Despite the benign US disinflation story, it is no surprise that markets are not flooding long EUR/USD positions. That has been an already relatively crowded trade, and the recent re-pricing of growth expectations of both growth and rate expectations in the eurozone is weighing on the euro's attractiveness. EUR/USD looks likely to keep trading range-bound (1.09-1.11) until signs of a US economic slowdown move the rate differentials back in the euro's favour.

Francesco Pesole

➡ GBP: Good GDP numbers no game-changer for the BoE

[June's growth numbers in the UK](#) beat expectations, helping to cement a 0.2% quarter-on-quarter figure for the second quarter. Digging into the details of the release, it appears that the surprise is entirely explained by a substantial jump in manufacturing production (up 2.4%), apparently related to pharma and car production. Anyway, the rest of the economy clearly showed signs of resilience too.

Our UK economist believes that the implications for the Bank of England are probably quite limited, given the numbers are not far from its forecasts and the focus is firmly on services inflation and wage growth, which are both out next week.

The pound is stronger this morning, shrugging off some recent softish momentum possibly related to news that the UK housing market was slowing more rapidly. Next week is a key one for the pound, expect some pre-CPI positioning to dominate in GBP trading and volatility to pick up.

Francesco Pesole

➔ CEE: Romanian inflation made it into single-digit territory

This morning we saw inflation in Romania fall from 10.3% to 9.44% year-on-year, below market expectations. Romania joins the Czech Republic in the single-digit inflation club within the CEE region. After today's numbers, we have the full picture for the region with 8.8% in the Czech Republic, 10.8% in Poland and 17.6% in Hungary.

Later today, the minutes of the latest Czech National Bank (CNB) meeting will be released. The board has formally lifted the FX intervention regime. So the minutes may show a discussion of FX, the impact on inflation and possibly the first discussion of rate cuts. Beyond that, the CNB will release the full inflation report including alternative scenarios, which are the board's preference at the moment. As the governor indicated, these envisage a later rate cut in the first quarter of next year instead of the fourth quarter of this year in the baseline scenario.

In the FX market, yesterday's trading despite our expectations was not negative, and despite the jump in gas prices, we saw gains across the board. The US dollar took control again and drove CEE FX to stronger levels. Today's trading should be rather quiet given that the calendar doesn't offer much.

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