

FX Daily: Dollar drops on the disinflation trade

The downside surprise in US June CPI inflation has seen the dollar drop to new lows for the year. Over recent months we had been speculating that clear signs of US disinflation - and a weaker dollar - may emerge in 3Q23 and yesterday's moves could well be the start of an important market adjustment. Look out for US PPI and US initial claims today



📉 USD: The start of something

It has been a long time coming, but yesterday's surprisingly [soft US June CPI numbers](#) may be the first sign this year that sharp Fed rate hikes are finally starting to bite. As our US economist, James Knightley, notes, there were welcome declines in all of the key categories of inflation. He does not think this will prevent another 25bp Fed rate hike at the 26 July meeting, but it will add weight to the view that the July hike may indeed be the last in the cycle. The data could also herald a change in the Fed narrative from frustration that inflation has not fallen as quickly as expected to a more welcoming approach to recent data releases.

We had discussed the potential FX market impact of a soft US CPI print in yesterday's [FX Daily](#) and the soft CPI has driven more benign pricing around the world - i.e. bullish steepening of yield curves, higher equities, narrower credit spreads, and a weaker dollar. FX price action has all the hallmarks of a position unwind, where those currencies sold on a bearish/hard landing scenario

(e.g. Norway's krone, Sweden's krona, and to a lesser degree some other commodity currencies) have now made a very strong comeback. Indeed, both the NOK and SEK had been extremely undervalued in our medium-term valuation models and are now finding room to breathe.

For the big dollar trend, this may be the start of the long-awaited cyclical decline. There are parallels to the dollar sell-off last November and December (when it fell 8% in two months), but the difference now is; i) positioning, where speculators are not as heavily long dollars as they were last October, and ii) the China and European growth stories do not seem due as much of a re-rating as they enjoyed last November.

That said, we prefer to run with the dollar bearish story for the time being, where DXY should press big psychological support at 100.00. The next target would be 99.00 on a breakout. For today, look out for US June PPI and the weekly initial claims number. A further decline in PPI and a rise in claims could see dollar losses extend.

Chris Turner

EUR: 1.1275 is the next target for EUR/USD

Soft US inflation data has been good news for all the pro-cyclical currencies including the euro. EUR/USD is comfortably trading at new highs for the year and the next technical target would be 1.1275 as it continues to retrace the 2021-2022 decline. For today, look out for the account of the 15 June European Central Bank meeting. Presumably, the ECB will see no advantage in trying to diffuse market pricing of two further 25bp rate hikes this year.

Elsewhere, we note EUR/CHF breaking down to some new lows. We would not chase this too much lower since the Swiss National Bank will be getting a lot of their desired appreciation in the nominal trade-weighted Swiss franc from the big move lower in USD/CHF.

Chris Turner

GBP: Cable up, EUR/GBP sideways

We are seeing a lot of correlation in short-dated yields around the world, where yesterday's soft US CPI data saw 22bp taken out of the Bank of England tightening cycle for early next year. The main takeaway from yesterday's Bank of England financial stability and subsequent communication appeared to be that consumers and businesses could withstand higher interest rates - were they to materialise. In addition, today's release of May UK GDP data has emerged marginally better than expected.

In some ways, sterling has already enjoyed its re-rating on the very hawkish BoE and thus may not outperform in this current dollar bear phase. However, many investors will now be targeting a move to 1.3300 in GBP/USD - assuming we can close the week above 1.30.

EUR/GBP has reversed off a low near 0.8500 - which now may mark the lower end of the trading range for this quarter.

Chris Turner

📈 CEE: Czech inflation back in single-digit territory

This morning Romanian inflation posted another decline from 10.6% to 10.25% year-on-year, in line with market expectations. Later today we will also see June inflation in the Czech Republic, which should complete the picture in the region. We expect a drop from 11.1% to 9.6% YoY, slightly below market expectations. This should put inflation in the Czech Republic in single-digit territory, the first country in the region to see this. The market at the moment is pricing in a roughly 100bp CNB rate cut this year. We expect the first cut in November with the risk of a delay until the first quarter of next year. However, we think rapid disinflation will be a signal for the market to price in more rate cuts and the market may stay in this mode all summer due to further falls in inflation. However, disinflation should stop in the autumn months, which will worry the central bank.

On the FX market, the Czech koruna has been stuck in the 23.60-90 EUR/CZK range for the past month, disappointing our expectations for a stronger koruna. Today's inflation number should be negative news for the CZK and the interest rate differential. However, the latter has not been a very strong factor in recent weeks and the main role, as in the rest of the region, is played by the global story, the higher EUR/USD and improved sentiment compared to last week. These indicate the scope for further gains. Thus, after a volatile morning, we expect the koruna to get back on track and test 23.750 EUR/CZK today. Elsewhere in the region, we continue to expect further gains for Hungary's forint and Poland's zloty for the same reasons. EUR/HUF could fall below 374 today and EUR/PLN below 4.430.

Frantisek Taborsky

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

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