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FX

FX Daily: Dollar rebound can gather some pace

Retail sales and jobless claims were better than expected yesterday, offering more support for a hawkish rethink of Federal Reserve rate cuts. We expect the residual 14bp priced in for September to be gradually reduced and add pressure on EUR/USD. Elsewhere, Japan's election on Sunday might trigger a break above 150.0 in USD/JPY



📈 USD: Momentum can build

The dollar index is on track for a second consecutive week of gains, having rallied over 2% since the 1 July low of 96.50. While modest compared to the steep losses in the first half of 2025, the dollar has realigned with core macro drivers and notably re-established its positive correlation with 10-year yields.

One of our key calls this summer is that this return to dollar 'functionality' reduces the likelihood of new selloffs - unless Trump fires Fed Chair Jay Powell (as Wednesday's brief dollar collapse showed) or escalates protectionism beyond markets' current tolerance, particularly against China. We don't expect either, and still see some dollar support in the coming months as the 14bp priced into the Fed's September contract unwinds.

So far, incoming data backs our view. Without Trump's relentless pressure and the dovish dissent from Christopher Waller and Michelle Bowman, September likely wouldn't be on the table. Yesterday, we heard from Waller that the Fed should cut rates at the July meeting due to the weakening labour market, while on the data side, retail sales came in strong and initial jobless claims continued to cool. Another surprise: TIC data showed huge \$311bn net capital inflows in May, following a very modest \$14bn outflow in April. This suggests foreign investors have not lost confidence in dollar-denominated assets, but anecdotal evidence continues to point to higher USD hedging activity, which has contributed to keeping the greenback weak.

Today's calendar includes some housing figures and the University of Michigan surveys for June. We'll see whether 1-year inflation expectations have continued to drop: they are currently at 5%, though opinions diverge sharply between Democrat (very high) and Republican (very low) responders.

Francesco Pesole

📉 **EUR: EU Commission budget likely to be watered down**

The EU Commission's EUR 2tn budget proposal has continued to face harsh criticism from Germany. Chancellor Friedrich Merz admitted it will be a "tough fight over the budget for the next two years". The chances of Ursula von der Leyen's proposal securing unanimous approval without being materially watered down look very slim.

That was, anyway, meant to be a long-term topic for the euro, which for now continues to track US developments amid dormant ECB rate expectations. But – as [Carsten Brzeski discusses here](#) – next week's ECB meeting may prove less dull than expected. A cut is highly unlikely given recent communication, but tariff risks and a strong euro could revitalise a dovish front that otherwise seemed settled on a neutral pivot.

That is another factor keeping us moderately bearish on EUR/USD, and we continue to favour a move to 1.150 in the near term.

Francesco Pesole

📉 **JPY: Sunday's vote could send USD/JPY above 150**

Japan's upper house election on Sunday has turned into a pivotal event for [JGBs and the yen](#). The recent jump in long-dated yields signals markets are likely pricing in a decent probability of PM Shigeru Ishiba's coalition losing its majority, which would pave the way for his potential resignation, and for tax-cutting plans by opposition parties to become a reality. On those, opposition leaders have actually tried to calm markets by arguing for the fiscal sustainability of any expansionary measure. There are also risks that delicate US-Japan trade negotiations could stall.

If this outcome materialises, there should be some extra pressure on long-dated JGBs, which could pave the way for USD/JPY to break 150.0. Ultimately, not all fiscal worries may materialise and the negative spillover into JPY should eventually ease. For the near term, renewed dollar momentum and rising scepticism over the Fed's capacity to cut rates are adding steam to the USD/JPY rally.

Francesco Pesole

➔ **CEE: Quiet finish in the region despite busy global story**

The end of the week in the CEE region should be quiet. The calendar doesn't have much to offer today. However, the global story continues to shape sentiment. Although yesterday we saw Hungary's forint outperforming its CEE peers, in the rates space we saw the opposite picture.

While Poland's zloty and the Czech koruna continue to be paid, leading to a wider interest rate differential, in HUF rates yesterday, we saw a reversal in the differential after nearly 10 days. Therefore, we believe EUR/HUF has little chance but to test new lows towards 398 and the current range of 399-400 should roughly still work. On the positive side, we have the National Bank of Hungary meeting next week, but given the market pricing, the hawkish tone should not bring much support for FX. Elsewhere in the region, rate-paying flows continue to support FX, and both CZK and PLN should retain some backing despite a stronger USD and their underperformance yesterday.

Frantisek Taborsky

Author

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Chris Turner

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

chris.turner@ing.com

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