

FX Daily: Dollar risk premium consolidating

Chinese data disappointment was not enough to trigger a broad-based rebound in the dollar, which continues to show some disinflation risk premium (i.e. short-term undervaluation). We'll monitor some US releases including retail sales today, on an otherwise very quiet day data-wise. In Australia, RBA minutes reiterated openness to another hike



We have published the July edition of [FX Talking: The dollar's break point](#) which includes our latest views and forecasts for G10 and EM currencies.

USD: No real benefit from China's data disappointment

This week had started with the question of whether the dollar could still suffer from the residual effect of the disinflation surprise amid a quiet data calendar and with the FOMC meeting (26 July) drawing closer. Yesterday's price action in FX saw a relatively sanguine reaction to the disappointing growth numbers out of China: the highly exposed AUD and NZD declined, but EUR/USD was unchanged despite European stocks' underperformance.

The lack of larger-scale dollar gains on the back of deteriorating Chinese sentiment indicates that markets remain reluctant to build back USD long positions for now. That must be weighed – however – with indications that the dollar is undervalued in the short-term vs some major currencies (excluding JPY): it may be a matter of time, or a simple lack of catalyst, to see some convergence of the dollar with its short-term drivers. As discussed in [yesterday's FX Daily](#), we may well see the dollar recover a bit of ground, although the mis-valuation gap can also be closed by a move in other market drivers.

Today, the market's focus will be on June's retail sales figures out of the US (expected to be quite strong), as well as industrial production, some housing data and TIC flows. These releases normally do not trigger wide market reactions by themselves, although a combined positive data flow today could at least help keep the dollar losses capped for now.

Francesco Pesole

📌 EUR: Stretched short-term valuation

European equities underperformed yesterday (while US stocks held up) on the back of Chinese data disappointment. Normally, that would translate into a weaker EUR/USD, not just due to the euro's (positive) and dollar's (negative) opposite to China's growth outlook, but also because of EUR/USD's elevated beta to eurozone/US relative equity performance.

In our short-term financial fair value model, EUR/USD overvaluation has exceeded 3.0% on the back of the pair's unusual moves, an indication of how the FX market is pricing in a disinflationary risk premium into the dollar (i.e. larger than what is factored in by rates and equities).

A speech by ECB member Francois Villeroy is the only event to watch in the eurozone today. EUR/USD kept rising in morning trading, although we suspect gains beyond the 1.1300 mark may prove to be unsustainable for now.

Francesco Pesole

📌 GBP: Softer into the CPI risk event

The pound has continued to show more vulnerability than most of its G10 peers at the start of this week. EUR/GBP has crept higher in the past few sessions, back to the 0.8600 gauge as volatility in global central bank tightening expectations after the US CPI slowdown seems to have asymmetrically hit those curves that had more room for a dovish repricing, like the GBP one.

We are also observing some positioning ahead of tomorrow's key release of the UK inflation numbers. [As discussed by our colleague James Smith here](#), CPI data will make or break a 50bp August rate hike by the Bank of England. Markets continue to lean on the hawkish side with their pricing: 44bp for August, 116bp in total. Still, peak rate expectations have remained volatile and were scaled back by nearly 15bp yesterday.

Today, the UK calendar is empty. We suspect EUR/GBP can remain broadly supported into tomorrow's CPI.

Francesco Pesole

📌 AUD: Minutes keep pointing at openness to more tightening

The minutes of July's Reserve Bank of Australia (RBA) minutes released overnight showed members see the policy rate as "clearly restrictive" at current levels and acknowledge the growth outlook has deteriorated. At the same time, considerable emphasis remains on the inflation backdrop and the explicit openness to more tightening if needed means that another hike remains possible should CPI figures surprise materially on the upside again. We currently expect one last 25bp hike in September.

AUD was very marginally impacted by the minutes, both because the narrative was largely unchanged from recent communication and because external factors are in the driver's seat at the moment. China's disappointing second-quarter growth figures are yet another confirmation that AUD has to discount its elevated exposure to Beijing for the time being. The big chunk of the re-rating of Chinese growth expectations has, however, already happened, and news on more stimulus from Beijing may open the door for some bullish opportunities for AUD.

Back to domestic factors, we'll closely watch June's jobs reports (out this Thursday), although the biggest risk event for AUD is on 26 July, when second-quarter CPI figures are released. AUD/USD may suffer from a USD rebound and lingering negative Chinese effect in the coming days, but we could see it consolidate around 0.6850/0.6900 in the next few weeks.

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