

FX Daily: Dollar versus Treasury correlation re-aligns

Yesterday's softer US May CPI data led to the usual pattern of stronger Treasuries and a weaker dollar. However, this might be short-lived, given the numerous risk events over the next month. Elsewhere, it seems everyone loves the euro. Policymakers will no doubt be promoting the 'global euro' today at a conference on financial integration



⬇️ USD: Dollar's glass is half empty

It is fair to say that dollar price action has been poor. Having spent the last 10 weeks discussing the breakdown in the dollar-US Treasury correlation as the 'Sell America' thesis took hold, investors noticed that the dollar was only too keen to revert to traditional correlations yesterday as the [soft CPI](#) sent US Treasuries higher.

DXY ended the day some 0.5% weaker – a typical reaction to some bullish steepening of the US yield curve on the view that the Fed had more room to cut. For reference, the soft CPI data put about another 9-10bp back into the expected 2025 Fed easing cycle. On the subject of Treasuries, how do we square the circle of a [strong 10-year Treasury auction](#) with a weaker dollar? It appears

that domestic bidders drove the strong auction, leaving the market to speculate on whether foreigners are divesting after all.

The dollar has also failed to enjoy any bounce on the news of progress in US-China trade negotiations. That may be because details of the deal have been very vague, but yesterday US President Trump also said that the Commerce Department would be sending out letters in the next week or so dictating 'take it or leave it' trade deals to the 20 or so countries currently involved in negotiations. This keeps the risk of a 9 July cliff-edge jump in tariffs on the table – again seen as a dollar negative.

There are probably only two factors which are supporting the dollar in the near term. The first is that the dollar is very stretched versus rate differentials. It is hard to see it falling a lot further without another decline in short-dated US rates. It is unclear whether US PPI or initial claims will deliver those lower US rates today. The second is geopolitics. Tensions are rising in the Middle East as speculation grows over a potential Israeli attack on Iran's nuclear facilities. Oil prices have been rising this week. Higher oil prices are a dollar positive by way of the US comparative advantage in energy independence. Any further developments here could see the dollar favoured for its liquidity – although the yen and Swiss franc would be in demand too.

DXY is pretty close to the April low at 97.90/98.00. We prefer to see that as the bottom of a trading range. But dollar price action has been poor and we are perhaps seeing the lagged impact of global portfolio re-allocation decisions, such as outright sales of US assets or increased hedge ratios. Certainly, lower short-dated US rates make it an easier decision to raise hedge ratios on US assets.

Chris Turner

EUR: Everyone loves the euro

The euro has been doing well this week and seems to be the big winner from the de-dollarisation story. A slightly more hawkish ECB has helped here, as has some weakness in the currencies of key trading partners, such as the UK. On the calendar today are a lot of ECB speakers. Probably up for discussion is whether the ECB needs to cut rates again in September. Price data and the ECB's wage tracker data suggest the ECB does have room to cut. And the market just about prices a cut for December.

As above, we do note that EUR/USD is trading way above levels justified by short-dated interest rate differentials. Our baseline remains that this 1.1550/1600 area is the top of a trading range – unless those rate differentials can have a big move in favour of the euro. But we do note the prevailing narrative on de-dollarisation and would not advocate aggressively fighting this dollar bear trend at these levels.

Elsewhere, it's not something that the spot FX market typically looks at, but we have a very [timely European conference today](#) on financial integration. The ECB and European politicians are keen to push the 'global euro' debate, but holding the euro back is the incomplete capital markets union. Today's conference, 'Advancing the Savings and Investments Union', will seek to cover those remaining 'To Dos', and any new developments here might get greater coverage than usual. We addressed this topic in our piece, '[Unipolar Disorder: How the euro can benefit from dollar disillusionment](#)'.

Chris Turner

GBP: A little underperformance coming through

Some softer UK April GDP data this morning has seen sterling come under more pressure. Here's what our UK economist, James Smith, thinks of the data: "Bit of a disappointing UK April GDP figure – down 0.3% on the month. Not a huge surprise. These figures have been hugely volatile recently. In part, that's a frontloading effect – manufacturing surged in Feb and has unwound since. But in general, there is mounting scepticism about the figures themselves, in particular given that for the past three years, the first half of the year has been stronger than the second, despite the data supposedly being seasonally adjusted. This suggests second quarter growth as a whole will come in around 0.1% or 0.2%, after 0.7% in the first quarter."

This softer GDP data, following the softer wage data earlier this week, will suggest the Bank of England does have good reason to cut rates after all. EUR/GBP is close to 0.8500 now, and the building narrative of wider eurozone versus UK policy rate spreads (the ECB has nearly finished easing, the BoE could accelerate rate cuts) warns that EUR/GBP trades to 0.8550 and 0.8600 on a multi-month view.

Chris Turner

Antipodeans: Consolidating upward trend

The Australian and New Zealand dollars are consolidating recent gains as US-China trade tensions have abated, while the USD failed to regain much ground. Pitching a big rally in AUD and NZD has been harder compared to the outperforming European currencies, which are incidentally benefiting from stronger repatriation flow effects. However, reduced external economic risks related to China can allow AUD and NZD to enjoy some outperformance relative to peers with similarly high beta to risk sentiment in the coming weeks.

The Kiwi dollar remains a more attractive option in our view as the Reserve Bank of New Zealand has signalled more cautiousness in easing further, while the Reserve Bank of Australia's dovish tilt suggests more room for cuts. We expect only one additional cut in New Zealand this year as services CPI may prove too slow to decelerate, while the RBA may deliver two if not three more. The erosion of AUD's rate advantage relative to NZD means periods of calm in risk assets can favour NZD more than AUD for the remainder of the year. For now, we stick with our short-term targets of 0.66 in AUD/USD and 0.61 in NZD/USD.

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