FX Daily: Eurozone inflation, round one

Spain and Germany will release inflation figures today, and market expectations for the ECB's September meeting may already be impacted. Eurozone numbers are out tomorrow. Meanwhile, ADP payrolls are out in the US after a soft batch of data hit the dollar yesterday, while AUD is shrugging off lower-than-expected CPI figures

USD: ADP could be inaccurate, but may move the market

Two softer-than-expected data releases in the US yesterday prompted a sizeable correction in the USD 2-year swap rate yields, which fell from 4.94% to the 4.80% area. JOLTS job openings data fell to 8.8 million in July, meaning there were approximately 1.5 open positions for each unemployed worker – the lowest ratio since September 2021. The hiring rate declined marginally, but the layoff rate was unchanged. Consumer confidence figures also disappointed, with the Conference Board survey dropping from a revised 114 level in July to 106 in August. Other components of the survey also declined.

The rally in pro-cyclical currencies and the dollar's weakness across the board was a confirmation of how US activity data – even if non tier-one releases – remain firmly in the driver's seat for global currency markets. Developments in China and in the commodity sphere, while important, clearly continue to play a secondary role.

Today, expect markets to focus on the ADP employment figures. These have not proven to be a very accurate estimator of the official payrolls recently but have often impacted rate expectations. The consensus is for a 195k print. Wholesale inventories and pending home sales for July, as well as the GDP and core PCE secondary release for the second quarter, are also on the calendar today.

The dollar is regaining some ground this morning after yesterday's losses, but data will determine the direction of travel today. We had called for a weaker dollar at the start of this week and we'd like to see whether eurozone inflation data boost the chances of one last hike from the European Central Bank. With markets being more convinced of no more hikes by the Federal Reserve – barring a surprise in payrolls – a re-tightening in the EUR/USD short-term real rate gap could set the tone for a weaker dollar across the world.

DXY may continue its correction from the 104.00 highs and test 103.00 should eurozone inflation figures come in strong enough and US employment not surprise on the upside.

Francesco Pesole

EUR: Spain and Germany release inflation figures

The first round of inflation figures out of the eurozone will see the release of Spanish and German CPI this morning. In Spain, headline inflation should rebound marginally from low levels (2.3%), but all eyes will be on core inflation, which remains elevated. The consensus is for a slowdown from 6.2% to 6.0%. Germany's figures will likely have the largest market impact. with the consensus also centred on a deceleration from 6.2% to 6.0%.

It is a crucial juncture for the euro. Markets approach the key risk event pricing in just slightly below 50% implied probability of another rate hike in September and 15bp in total. The EUR curve appears to largely agree with our view that if the ECB skips the September meeting, it will find it increasingly hard to raise rates again at all given the deterioration in the eurozone economic outlook.

We expect markets to be very sensitive to even the smallest deviations from consensus, especially in Germany's figures and the eurozone-wide numbers released tomorrow. We admit it's a very close call, but our economists expect this week's inflation reports to signal that core inflation remains too high for comfort and lead the ECB to one last rate hike in September.

In our base case scenario, we see EUR/USD rally into the 1.0900-1.0950 area into the US payrolls on Friday.

Francesco Pesole

GBP: Unlucky bystander

The lack of domestic data releases has left the pound moving merely in line with global dynamics. Yesterday's drop in the dollar sent Cable above 1.2650, a smaller rally compared to other peers. This morning, GBP/USD is inching lower along with other dollar crosses, although it appears that the pound's sensitivity to risk sentiment is a bit more limited at this moment.

EUR/GBP is the pair to watch today as inflation data in the eurozone are released. The pair broke above 0.8600 yesterday, and signs of resilient inflation in Spain and Germany could see the rally extend to test the 0.8640 100-day MA.

On the UK side, it will be worth watching mortgage approval figures for July along with other credit statistics. Surging rates and declining demand for loans have already triggered a house price correction in the country.

Francesco Pesole

AUD: Lower inflation doesn't hurts Aussie dollar

The Aussie dollar dropped temporarily to 0.6450 before rapidly rebounding after monthly inflation figures surprised on the downside overnight. CPI inflation for the month of July came in at 4.9%, a decline from 5.4% and below the consensus of 5.2%.

As discussed by our colleagues here, this means our call for one last RBA hike in the fourth quarter now hangs by a thread, given how much weight policymakers have been putting on the monthly inflation figures of late. We are still not convinced the path for disinflation will be a smooth one, though, since base effects have been doing a lot of the heavy lifting in bringing inflation lower in the past months. At this point, labour market data become more relevant. Should we see another soft read, the chances of one last rate hike by the RBA would become extremely slim.

From an FX perspective, we are not surprised to see the AUD trading higher despite the softer inflation figures. We have been highlighting how AUD/USD was embedding a good deal of negatives related to Australia's exposure to China, and market expectations for RBA tightening were very limited even before today's CPI release. We like the chances of an AUD/USD rebound from these levels.

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