FX Daily: Inflation divergence widens in G10

Many USD crosses are being kept in a stalemate by the Fed versus Trump dichotomy. Domestic inflation data has been in focus around the pro-cyclical G10 FX space in the past 24 hours. Sterling is trading higher after inflation flatlined in June, CAD suffered from softer CPI endorsing a BoC cut next week, and NZD rose as non-tradable inflation slowed less than expected

USD: Trump trade versus Fed trade

The June US retail sales report exceeded expectations yesterday, with headline sales remaining flat on the month against a consensus 0.3% MoM drop. While motor vehicle sales fell 2% MoM and gasoline station sales dropped 3% due to lower prices, other less volatile areas performed well. Despite the positive data, real retail sales are still around 4 percentage points below their 2021 peak. Slower consumer spending growth, moderating inflation, and rising unemployment rates may impact the sector going forward, and we still expect this to feed into a narrative of lower Fed rates.

Those figures did not dent the market's dovish call on the Fed. A September cut is fully priced in, and 65bp of easing is factored in by year-end. The reason why the dollar has been resilient despite the rise in dovish bets is undoubtedly the emergence of “hedges” for higher inflation, tariffs, and geopolitical risks ahead of a Trump re-election, which is perceived as more likely after the weekend incident.

Last week, we were still arguing for some short-term USD weakness on the back of US macro news, but after recent developments in this week’s price action so far, the risks for the dollar are much more balanced. Periods of USD outperformance this summer are more likely as markets have a clear inclination to play the “Trump trade” well ahead of November.

The US data calendar includes housing starts, building permits and industrial production for June today. The Fed will release the Beige Book this evening, which may signal some regional strains in the jobs market, ultimately making Fed communication drift further to the dovish side.

We continue to expect some stabilisation in USD crosses before the end of the week. The commodity FX space remains in a vulnerable position, and the Canadian dollar received an additional hit from lower-than-expected CPI yesterday. We now expect the Bank of Canada to cut rates by another 25bp next week, in line with market pricing.

In New Zealand, headline CPI slowed slightly more than expected from 4.0% to 3.3% in the second quarter. However, that was entirely driven by tradeable CPI, while the non-tradable CPI index slowed less than expected, from 1.6% to 0.9% QoQ against expectations for 0.8%. Given the recent dovish turn by the RBNZ, markets were probably expecting a more decisive decline in non-tradable inflation, and NZD rose after the release.

Francesco Pesole

EUR: Stuck at 1.090, for now

EUR/USD continues to trade close to 1.090, a level that symbolises the current balance between USD-positive US political developments and USD-negative Fed rate repricing. But there remains very little contribution from the euro leg to the pair’s recent price action.

On the data side, we saw ZEW surveys yesterday, which confirmed expectations for a drop in the German expectations gauge, but also a surprising recovery in the current situation index – perhaps on the back of the more market-friendly result of the French election. The eurozone-wide expectations survey contracted too, confirming the loss of momentum in activity sentiment over the past month.

We expect this cool-off in the eurozone’s growth outlook can coincide with markets becoming gradually more nervous about the French fiscal situation as the political gridlock continues. That is one of the reasons why we continue to see 1.08 as more likely than 1.10 in the coming weeks. As we discussed in our July’s ECB Cheat Sheet, we think the Governing Council will refrain from offering new guidance tomorrow and the market impact of the meeting may be very limited.

The only event to watch on the macro side in the eurozone today is the final release of CPI data for June. Consensus is not expecting any revision from the flash estimates, which saw headline inflation at 2.5% and the core gauge at 2.9% YoY

GBP: Disinflation still slow

The CPI report for June, released this morning, showed things continue to move slowly on the disinflation front in the UK. Headline, core, and services inflation were all unchanged since May, despite expectations for a marginal slowdown. We know that services inflation is what the Bank of England is mostly focused on at this stage, and the stabilisation at 5.7% YoY in June does not endorse any additional easing bets ahead of the 1st August meeting.

The pound is understandably trading on the strong side this morning as markets are scaling back some dovish rerating in the Sonia curve. Now there are -9bp priced in for August versus -12bp prior to the release, and the year-end pricing is for 48bp of rate cuts.

Our economists' long-standing call has been for the BoE's easing cycle to start in August, but we admit the chances are somewhat lower after this morning's CPI report. Markets may also gradually price out an August move in the coming weeks, which would make a potential cut a very negative event for the pound. For now, EUR/GBP long-term bulls like us will be happy to see the pair hang on around 0.8400.

Francesco Pesole

CEE: First signs of reconnection with rates

In the Czech Republic the PPI numbers for June will be released later this morning which should show roughly stable prices month-over-month and only a slight 1.3% increase year-over-year. Otherwise, the calendar is empty in the region today. That said, the FX market is getting more interesting. In the CZK, dovish pricing seems to have hit its limit and rates have rebounded slightly for the first time in two weeks. EUR/CZK still maintains a close relationship with rates here and we have moved a little closer to 25.30 again and we expect to go below that level.

However, in the rest of the region, the FX market seems to be ignoring the massive rally in the rates space and below the surface the market is getting into gear. EUR/PLN weakened above 4.280 for the first time in a week, closing the gap with rates as we mentioned here on Monday. Given the size of the move in PLN rates, we think there is still some near-term potential for the currency to weaken closer to EUR/PLN 4.300. However, our medium-term view remains positive and we think this will again make the market an attractive level to build a new position here. EUR/HUF has been showing an early disconnect from rates for some time now, pointing to a weaker HUF. The last two days we have seen EUR/HUF attempt to go up but so far without success. Here we think the market is waiting for the NBH decision next week.

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