

## FX Daily: Jumping on the inflation swing

Today's CPI release in the US is arguably the biggest risk event of the week. This is because it can tilt the balance ahead of a 'toss-up' FOMC announcement tomorrow, and because anything ECB related may well play second fiddle to moves in USD rates. A 0.4% MoM core consensus read should, in our view, allow the Fed to stay on hold, but may not hit the dollar just yet



*We have published the June edition of [FX Talking: "Burden of proof"](#), which includes our latest views and forecasts for all G10 and EM currencies.*

### ➔ USD: Small deviations in core inflation can have huge implications

The currency and rates markets approached this week with a very elevated beta to data releases as markets remained on the lookout for hints on the activity and employment outlook ahead of the Fed's policy announcement tomorrow. Inflation, however, remains the single most important input in the FOMC's decision-making equation, and today's CPI numbers for May likely have a make-or-break potential for a 25bp hike tomorrow, which is currently priced in with a 23% implied probability.

The median consensus estimate for the month-on-month core CPI read – which will effectively move markets – is 0.4%, with estimates ranging from 0.3% to 0.5%. A 0.4% MoM print (translating into a 5.2% core year-on-year rate) is also our economics team's call, and one that would in our view allow the majority of FOMC members to [favour a hawkish hold](#) over a 25bp hike tomorrow. It would probably take a 0.3% read to price out the residual 23% implied probability of a hike tomorrow, meaning that the dollar does not need to fall much on a consensus print today.

The spectrum of market reaction is much wider in the event of a 0.5% MoM core inflation read. We think the odds would likely swing in favour of a hike tomorrow, and markets could push their implied probability above 50%, sending the dollar higher across the board. The most visible consequence in G10 FX would probably be another jump in USD/JPY (ultra-sensitive to Fed pricing) and a potential break above the 140.90 end-of-May recent highs.

In terms of the headline measure, the consensus is expecting a month-on-month 0.1% change, translating into a slowdown from 4.9% to 4.1% YoY. But it will almost entirely be up to the core rate to drive the market reaction.

*Francesco Pesole*

## ➔ EUR: Don't look at the eurozone, look at the US

We have published the [ECB Cheat Sheet](#) ahead of Thursday's policy announcement in Frankfurt. A 25bp outcome has already been priced in by markets and looks like a done deal based on recent ECB communication, so the focus will be on the commitment to future tightening. Arguably, the grounds to retain a hawkish stance have become scarcer since the softening of the inflation and growth story in the eurozone, and the chances of a hawkish surprise have therefore decreased.

From an FX perspective, we do not see the ECB risk event this week as big as anything happening in the US. The recent EUR/USD decline was caused by a deterioration in the EUR-USD short-term rate differential, but that was overwhelmingly driven by a jump in the more volatile USD rates while EUR rates remained stable. US CPI numbers and the Fed decisions are what will matter the most for EUR/USD this week, and more generally, US data and the Fed's future path are what will primarily determine the direction of EUR/USD moving ahead.

If we are right about a 0.4% core US CPI print today, there may be some moderate upside risks for EUR/USD, should investors see that as enough to price out the remaining 23% implied probability of a hike tomorrow. But we are not convinced of that and some cautious trading ahead of key central bank risk events may keep the pair capped.

*Francesco Pesole*

## ➔ GBP: UK jobs markets stays hot

Data out of the UK this morning point to ultra-tight conditions in the jobs market, as unemployment unexpectedly fell again to 3.8% and average weekly earnings jumped from 5.8% to 6.5%.

Our UK economist discusses [in this article](#) why sticky UK wage inflation means very low chances of Bank of England rate cuts before 2024. We are less convinced this will lead to several more rate hikes by the BoE: markets are currently pricing in 100bp of tightening to the peak, but we struggle to see more than two 25bp increases (in June and August).

We keep highlighting the risks for sterling of a dovish repricing in the BoE rate expectations down the road, but with data pointing consistently to more tightening recently, it's hard to buck the bullish GBP trend in the near term. Still, GBP/USD may well default to being driven by the dollar leg as soon as the US CPI risk event kicks in.

*Francesco Pesole*

## CEE: Global story favours stronger FX

Romania's inflation numbers for May were released this morning, showing a drop from 11.2% to 10.6% YoY, above market expectations. At the same time, Romania confirmed the lowest inflation within the CEE region. For the rest of the day, the calendar doesn't have much to offer. In the Czech Republic and Poland, we will see April's current account numbers, which recently turned into a surplus in both countries.

Otherwise, the global story will be more interesting for FX markets. Higher EUR/USD and risk-on sentiment indicates positive conditions for CEE FX. The Czech koruna should correct slightly towards 23.75 EUR/CZK after yesterday's depreciation to almost 23.80 EUR/CZK. However, the main focus will be back on the Polish zloty, which is holding near record strong levels ahead of Thursday's European Court of Justice ruling on the FX mortgage case. Given the favourable global conditions, we see no reason for depreciation for now, rather we expect a stagnation around EUR/PLN 4.45.

*Frantisek Taborsky*

### Authors

#### **Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

#### **Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

#### **Chris Turner**

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

[chris.turner@ing.com](mailto:chris.turner@ing.com)

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