FX Daily: Markets setting sights on next week's US CPI

A fifth straight decline in initial jobless claims places even more emphasis on Tuesday's CPI data to vindicate markets' residual bets on a September Fed cut. The consensus view has now emerged: a 0.3% MoM core CPI print. Before the key inflation test, EUR/USD may not trade too far from 1.170, but risks are admittedly more balanced now

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USD: Eyes on next week's CPI

The US dollar remains highly sensitive to data, while tariff news continues to have only a limited effect. Overnight, US President Donald Trump has threatened a 35% tariff on select Canadian goods starting 1 August and floated the idea of blanket tariffs of 15-20% on most US trading partners, up from the current 10% baseline. In a letter to Canadian Prime Minister Mark Carney,

Trump cited "unsustainable trade deficits" driven by Canada's tariff and non-tariff barriers.

Yesterday's fifth straight decline in initial jobless claims has reinforced the narrative that a sharp deterioration in the jobs market is unlikely to be what prompts the Federal Reserve to cut as soon as September. This puts even more emphasis on inflation data, due Tuesday. Consensus is centred around a 0.3% month-on-month core print, which would push the year-on-year rate slightly higher, from 2.8% to 2.9%. If it weren't for the explicit dovishness from Christopher Waller and Michelle Bowman, and Trump's persistent pressure on the Fed, a print like that would probably be enough to rule out a September cut. As things stand, it may take a 0.4% print for markets to fully price that out.

Today, the Federal budget balance for June is expected at -$30bn. While a major deviation could have some FX impact, the budget story appears to have been put on the back burner by markets for the moment. Tariffs, too, continue to touch the dollar only marginally. Our view remains that unless the US targets its biggest partners – China, the EU, Mexico, or Canada – with new tariffs, the dollar is likely to look through this round of protectionism, with the FX fallout limited to local impacts, such as for BRL as discussed below. DXY may hold near the 97.50 level or trade modestly higher on some positioning adjustments ahead of next week's CPI.

Elsewhere, Canada releases June jobs data today. Consensus is for no change in employment, while the unemployment rate is expected to edge up from 7.0% to 7.1%. Recent government spending cuts point to an increased risk of job losses, and in our view, markets continue to underprice the probability of a September rate cut by the Bank of Canada (15bp). A particularly weak jobs print could even spark speculation of a move as early as 30 July. It may be too soon to position for CAD weakness ahead of any clarity on the US-Canada trade deal, but we continue to see the loonie as broadly unattractive.

Francesco Pesole

EUR: Awaiting news on EU-US trade talks

There is still no news on the EU trade proposal to the US, but in our view, an EU–US trade deal is unlikely to have a significant directional impact on EUR/USD, which remains primarily tied to Fed and US data dynamics. However, in the absence of major data releases, markets may make some short-term adjustments should details of a draft deal emerge already today.

On the European Central Bank front, communication has been quiet, particularly on the topic of euro strength, despite it featuring heavily in Sintra discussions. Interestingly, French Prime Minister François Bayrou called on the ECB to provide more support via looser monetary policy. While this is unlikely to sway the Governing Council directly, it might highlight growing unease among European leaders about the risks of keeping rates on hold for too long, especially with a strong euro weighing on exports.

EUR/USD briefly dipped as low as 1.1670 yesterday, and while near-term risks look more balanced, if anything slightly skewed to the downside, the lack of fresh data suggests the pair may remain anchored around 1.170 for now.

Elsewhere, UK May GDP was disappointing, recording a second consecutive fall against consensus expectations of a small rise. The truth is these figures are highly volatile, in part because the first quarter was boosted by tariff frontloading and home sales ahead of the Stamp Duty hike in early

April. The Bank of England looked through the spike in Q1 GDP, concluding instead from the broader survey data that underlying activity was more or less flat. We'll get more colour in next Thursday's jobs report, and if things are bad, it would put serious pressure on the BoE to speed things up on rate cuts. However, sterling opens unchanged this morning, suggesting a similar market view.

Francesco Pesole

RON: A weaker currency

This morning, we saw inflation and wage numbers in Romania, the latest within the CEE region. Inflation picked up from 5.5% to 5.7%, slightly above market expectations, while wages slowed down a bit. While recent developments suggest that inflation is a bigger issue in Romania, the key test will be the impact of the fiscal package for the rest of the year.

Our economists have lifted their year-end inflation forecast up from 6.0% to 7.5% with the expectation that we will see numbers around 8% in September and October as the peak. The main reason for this is higher taxes and, in particular, a higher VAT rate. Therefore, it is almost certain that we will not see rate cuts from the National Bank of Romania this year, given that the central bank will likely want to wait.

EUR/RON has been hard to read since the May sell-off, and it seems both the market and the central bank are still looking for the right new level. For now, the 5.020-5.080 range seems to be working, but previously, we and the consensus were expecting to see EUR/RON closer to the lower bound of this range, given the central bank's continued efforts to push against inflation.

Still, let's not forget the massive current account deficit in Romania, which is naturally making the currency weaker. Some parts of the market may consider the fiscal story resolved, and closing long bond positions is having a similar effect. So, at the moment, we are more likely to stay at the top of this range.

Frantisek Taborsky

BRL: No knock-out blow from US tariffs

Brazilian asset markets have taken news of a 50% US tariff in their stride. Local equity markets were off less than one per cent, and the Brazilian real has reclaimed half of Wednesday evening's losses. Limiting the fall-out has been Brazil's relatively smaller exposure to exports than its Latam peers. Exports to GDP are around 18% in Brazil, versus levels of around 30-35% for Mexico and Chile. Only around 10% of Brazil's exports go to the US – largely in the form of energy and industrial metals. China is a much bigger market for Brazil's exports.

At the same time, investors are no doubt weighing up the probability that the 50% US tariff stays at that level for long. Does President Luiz Inácio Lula da Silva have something other than compromising the local judicial system that President Trump wants, meaning that the 50% tariff rate gets cut?

At this stage, we do not think the real has to fall too far. Drivers of this year's 11% spot and 19% total return in the real against the dollar have been Brazil's 15% interest rate and a relatively benign external environment once Trump shifted to deal-making on tariffs. A trickier external environment makes a return to the recent 5.40 low in USD/BRL unlikely this quarter. But equally,

we don't see a case for a sharp spike through 5.75 and would expect the real to outperform the steep forward curve this summer.

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