

FX Daily: Sticky US inflation to keep dollar bid

Today sees the last major US inflation report ahead of the next FOMC meeting on 20 September. Higher gasoline prices and base effects are expected to push August CPI up to 3.6% YoY, and on a core and month-on-month basis, we also see an upside risk to the 0.2% MoM consensus estimate – clearly not enough to feed a bearish dollar narrative



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📈 USD: CPI figures to keep the dollar firm

The highlight of today's session will be the August US CPI release. As our US economist James Knightley discusses [here](#), the headline year-on-year rate is expected to rise to 3.6% from 3.2% on base effects and higher gasoline prices. And while the core YoY rate may drop to 4.4% from 4.7%, an above consensus core month-on-month reading – possibly on the back of airfares and medical costs – will hardly support any narrative of the Federal Reserve's work being done. This will probably lay the groundwork for a reasonably hawkish FOMC meeting this time next week, where despite unchanged rates, the Fed will (through its Dot Plots) hold out the threat of one further hike this year.

All of the above should keep the dollar reasonably bid and keep policymakers in the likes of China and Japan busy fighting local currency weakness (more below). We are bearish on the dollar from the [fourth quarter of this year](#), but this bearish narrative requires a few more weeks of patience. We favour DXY edging back to the top of its 104.50-105,00 range today.

Chris Turner

➔ EUR: High ECB inflation forecasts provide a little support

The euro received a little support overnight on a Reuters report that the new European Central Bank staff projections being released tomorrow would forecast CPI above 3% next year, compared to expectations of 2.7%. The implication here is that, based on these forecasts, the ECB would likely be more hawkish and supportive of the euro. As we discuss in our [ECB cheat sheet](#), there are many moving parts to tomorrow's meeting. However, the biggest part should be a 25bp rate hike – which is only 54% priced – and a factor that should see EUR/USD hold support down at 1.0700.

Chris Turner

⬇ GBP: Rolling lower

As we discussed in yesterday's [FX Daily](#), the market did read the latest wage developments slightly dovishly and re-priced both the Bank of England tightening cycle and sterling lower. It is quite incredible to see the Bank Rate now priced just above 5.50% next February. This terminal rate had been priced close to 6.50% just a few months ago.

If we are right with our call for an ECB rate hike tomorrow, EUR/GBP could edge up towards the 0.8670 area. And given that we like a continued strong dollar in the short term, expect GBP/USD to press the 200-day moving average at 1.2430. Recall that based on speculative positioning data, both the euro and sterling look the most vulnerable to further dollar strength.

Chris Turner

➔ CNH: The battle for funding

The offshore renminbi, the CNH, is starting to find some support and this largely looks down to developments in money markets. While the Chinese currency has been seen as a popular funding currency this year, it looks like Chinese authorities might be trying to intervene in money markets to make funding more expensive.

For example, one-month CNH implied yields are now 5.20% – the highest level since late 2018. The strategy here seems to be activity in short-dated CNH swap markets on the view that CNH rates can be more easily influenced than onshore rates since the stock of CNH cash is so much smaller than the stock of onshore cash. Equally, the People's Bank of China (PBoC) open market operations seem to be draining CNH liquidity. For example, the rollover of 6-month offshore PBoC bills on 19 September will result in a CNH10 billion drain in liquidity.

PBoC activity to drain CNH liquidity and support the currency is clearly incongruous with broader monetary easing to support the economy. This means that USD/CNH will probably not sell off that much further. But the strategy looks one of buying time until the major dollar trend turns, which may occur in the fourth quarter of this year.

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