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FX Daily: Still no guidance by the ECB, but watch for FX comments

A US-EU deal is reportedly imminent and should follow the US-Japan 15% tariff blueprint. The ECB should anyway tread carefully and offer no new guidance, but comments about the euro's strength can be read as dovish. We think EUR/USD may be close to a peak and we favour a correction in the near term. The yen's rally also appears to have gone too far

Trade and the euro's strength are the two hot topics in Frankfurt today. Pictured: The European Central Bank building

USD: Looking cheap

The dollar didn't suffer in the first half of July from trade tensions re-escalating. And it is equally finding no benefit from positive trade deal news. As a potential blockbuster deal with the EU may be announced in the coming days after yesterday's US-Japan agreement, the dollar impact may also prove to be mostly neutral.

If the greenback is indeed due a short-term recovery (we still think it is), then that will need to be triggered by data rather than tariff news, in line with the recent rise in most USD crosses' sensitivity to short-term rate differentials.

But this week has been quiet on data, and that has seemingly allowed some rebuilding of USD shorts. Today's calendar is more crowded, with focus on new home sales (yesterday's existing home sales came in soft), S&P Global PMIs and above all jobless claims. Initial claims have been on a five-week downward trend and continuing claims have plateaued since mid-June. With only eight days until the US jobs report, another strong print today can drive NFP expectations a bit higher. The whisper number is currently 110k.

Markets still price in 16bp of easing for September, which is the contract where we see the greatest potential for a hawkish repricing driving some dollar recovery.

Francesco Pesole

EUR: Will the ECB comment on the euro?

The ECB announces monetary policy today and is widely expected to keep rates on hold. As discussed in the ECB cheat sheet, trade and the euro's strength are the two hot topics in Frankfurt today. A few reports suggest that a US-EU deal is imminent and should follow the Japanese blueprint announced yesterday, so 15% tariffs on EU exports.

If the ECB is feeling confident that a trade deal is coming, the risks of a dovish surprise are indeed lower. However, the currency discussion remains a wildcard that poses downside risks for the euro. A few members have been unusually vocal about the euro's strength, and there is a chance some FX comments can make their way into today's communication. After all, the ECB has been focused on the theme of inflation undershooting, and a strong domestic currency does contribute to that. It remains to be seen whether the ECB feels currency remarks might hinder US-EU trade relations, considering Trump's sensitivity to FX manipulation themes.

In terms of guidance, don't expect anything new from the ECB, which should limit the market impact of today's meeting. Policymakers have reiterated that monetary policy is in a "good place" given subdued inflation, but the Governing Council is probably happy with markets pricing in just one cut by year-end.

We think there are still some modest downside risks for the euro today, but if the ECB steers away from commenting on the euro's strength, keeps guidance unchanged, and markets feel even less chance of a September move, EUR/USD could break above 1.180. Today's PMIs (released before the ECB announcement) may not have much of a market impact.

Francesco Pesole

JPY: Lots of positives in the price

The yen has continued to strengthen overnight, remaining the best performer in G10 since the start of the week, up 1.8% against the dollar. The US-Japan trade deal is seemingly reinforcing market expectations on a Bank of Japan rate hike by the end of the year, which is now 20bp priced in, up from 16bp earlier this week and a 10bp low earlier in July.

While our BoJ call has been generally more hawkish than pricing, it seems to us markets are underestimating the risks of a new prime minister potentially favouring a more cautious approach to rate hikes.

The yen may have used up its short-term bullish ammunition with the post-election “sell the fact” effect and the US-Japan trade deal, and we expect a rebuilding of USD/JPY longs around current levels ahead of potential political turmoil and lingering debt concerns. A return to 148.0 remains achievable over the next few days.

Francesco Pesole

TRY: Restart of cutting cycle is here

The Turkish central bank is likely to return to the cutting cycle today after tightening conditions in March and April. We expect a 250bp cut to 43.50% in line with market surveys. However, expectations are tilted towards a larger rate cut. At the same time, the CBT usually follows market expectations and likes to stay on the hawkish side to maintain TRY stability. Therefore, 250bp seems the safest to restart the cutting cycle that began late last year.

Although inflation expectations continue to decline gradually and inflation has seen some slowdown in recent months, the overall picture is not ideal for the central bank. The economy is visibly slowing down but inflation expectations for the end of this year remain well above the CBT forecast, close to 30%, which is also our forecast (29%). So today we will be closely monitoring the size of the rate cut, as it will reveal the central bank's willingness to consider further cuts. Additionally, the forward guidance provided will offer more insights. We expect another 250bp rate cuts this year with 35% by year-end.

USD/TRY continues its gradual upward trajectory with the recent break of the 40.00 level, and not much will change here in the near term in our view, with 43.00 at the end of this year. The central bank has been allowing less carry for long TRY investors in recent months but at the same time seems to have FX fully under control, reducing the chance of any sudden USD/TRY moves to the upside. The market has also priced in more rate cuts and OIS and FX implieds have essentially returned to almost pre-March levels, making pricing less attractive here. Overall, TRY still offers a reliable source of safe carry, but the returns have understandably diminished as the CBT moves to normalise conditions.

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