

FX Daily: Tectonic shifts in FX positioning

Dollar long positions are evaporating rapidly, with PPI numbers all but confirming the disinflationary narrative in the US. It's hard to find a clear counterargument against the bearish dollar momentum, but the move is looking stretched, so watch for potential temporary corrections. In Sweden, sticky inflation should keep the Riksbank hawkish



📈 USD: Army of bears growing stronger

The disinflation narrative has landed heavily on the dollar, and a look at the next couple of weeks – in the lead up to the July FOMC meeting – shows that there aren't many other data releases that can drastically turn the tide for the greenback. In yesterday's FX Daily, we mentioned a parallel with December's dollar sell-off and stressed how the dollar positioning was considerably more stretched to the long side back then. This is not a secondary aspect, especially given the wide post-CPI moves pointed at some large position squaring dynamics, which suggests the dollar is now looking at an even more balanced positioning now.

That being said, it's hard to build a strong counterargument to the bearish dollar momentum, especially after PPI data yesterday confirmed inflation is dissipating in the US. Our US economist notes that the key story for CPI and the PCE deflator down the line is the ongoing normalisation in

corporate profit margins. Should economic headwinds intensify, there would be scope for a proper contraction in margins (as companies push up price competition) and that can provide extra help in taking inflation well below target next year.

With CPI and PPI decelerating, it will be interesting to see how quickly inflation expectations are declining. The University of Michigan will publish expectation surveys today, and that will be the biggest event for markets. There are no scheduled Fed speakers, and FOMC participants will stir away from public remarks from today as the pre-meeting blackout period kicks off. Yesterday, James Bullard surprisingly announced his departure from his role as President of St Louis Fed. He has been the most hawkish FOMC member recently, but the St Louis seat is not up for voting until 2025.

In other central bank news, the Australian Treasury Minister Jim Chalmers decided not to reappoint Philip Lowe as RBA governor, and appointed deputy governor Michele Bullock as the new head of the central bank. Her latest comments have been in line with the broader RBA messaging, stressing data dependency and leaning on the hawkish side of the spectrum. She will take over in September, and the policy implications should be limited for now.

DXY broke below the 100.00 barrier yesterday, and the next logical support would likely be at 99.00. A pause or upside correction in the dollar could come at any time given the large swings of the past couple of days. This morning's moves suggest we could see some re-adjustment/stabilisation happen today with a quiet calendar. However, downside risks will keep prevailing for the dollar in the near term.

Francesco Pesole

📉 EUR: Rally looking a bit stretched

EUR/USD has taken off on the back of US disinflationary bets and a large unwinding of dollar positions. Our short-term fair value model shows that the pair has now entered overvaluation territory (around 2.0%), a clear signal that the move has exceeded what can be explained by market factors (rates, equities).

As discussed above, it seems difficult to build a strong counterargument to the bearish USD narrative at this stage and while some correction after a large and possibly overstretched move is possible, the near-term outlook may stay broadly bullish on EUR/USD.

The eurozone calendar only includes the trade balance data for May, with European Central Bank speakers scheduled. EUR/USD may stabilise around 1.1200 today, or even correct lower back to the 1.1170-80 area in the currently highly volatile environment.

For the pound, this could translate into a pull-back to the 1.3050-70 area. Looking ahead, GBP surely faces some clearer downside risks than the euro given the greater room for a dovish repricing of Bank of England rate expectations compared to the ECB's. The latest wage data pointed at another 50bp hike in August, but next week's CPI release is still an important risk event.

Francesco Pesole

📉 SEK: Sticky inflation, again

Inflation in Sweden kept decelerating at a slower pace than expected, especially in the core

measure – which is what the Riksbank primarily focuses on. June CPIF data released this morning showed a slowdown from 6.7% to 6.4%, although the key measure that excludes energy only moved from 8.2% to 8.1%.

The Riksbank has repeatedly signalled how a weak krona was likely hindering efforts to tame inflation, and data seem to confirm those fears. The late-June hawkish pivot helped halt the SEK slump, but it's really been all up to the external environment to drive the huge rally of the past few days. SEK and NOK have rallied 6% against the dollar this week, a sign that those were indeed the two major shorts still being held to play the prolonged US inflation/inverted yield-curve narrative.

The krona's recovery is offering some breathing room for the Riksbank, but evidence of sticky inflation – paired with those of rebounding long-term inflation expectations – all suggest a hike at the September meeting is quite likely. That, however, may well be the last move of the cycle, as the krona may also find a more stable path to recovery.

The plunge in EUR/SEK below the 11.50 mark surely raises some sustainability questions. We have discussed above about the risks of a re-adjustment after large moves: SEK would in theory be hit harder than other currencies in a correction, although inflation data this morning may at least make it less vulnerable than NOK. This morning, the troubled Swedish landlord, SBB, is reportedly in talks with bond investors. This is still a story to keep a close eye on, and remains a downside risk for SEK.

Francesco Pesole

CEE: Rally slowing down but we still expect more

This morning, we have already seen the data from the industry in Romania for May, which posted 1.8% year-on-year. Later today, we will see the final inflation data in Poland. We expect a confirmation of the decline from 13.0% to 11.5% YoY. Later in the day, we will see the current account results for May in the Czech Republic, Poland and Romania, which have improved significantly in recent months.

CEE FX slowed its rally yesterday, however we still expect more across the board. Global sentiment remains the main driver in our view and this should continue to support the region to stronger levels today. For the Hungarian zloty, we expect to get below 373 EUR/HUF, the Czech koruna closer to 23.700 EUR/CZK and the Polish zloty to 4.430 today.

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