FX Daily: The pound's big repricing is finally happening

UK inflation slowed more than expected in June, triggering a large dovish repricing in Bank of England tightening expectations and hitting the overbought pound. We now think a 25bp hike looks more likely than a 50bp move in August. GBP may stay under pressure, especially against the dollar – which we still expect to recover some ground into the FOMC meeting

USD: Slowly regaining ground?

The round of US data releases was quite mixed yesterday, and as discussed by our US economist in this note, likely supported the case for a pause after a July hike by the Federal Reserve. June's headline retail sales came in a bit softer than expected (0.2% month-on-month) but the control group which excludes some volatile components actually beat consensus (0.6% MoM). The real data miss came on the industrial production side, which confirmed the negative indications of a contracting ISM index and fell 0.5% MoM in June, despite expectations of 0% growth.

All in all, markets aren't lacking evidence of slowing activity in the US, and the addition of the favourable disinflationary backdrop now weakens the case for another hike beyond July. The lagging unemployment remains the last piece of the puzzle to smoothen the transition to a more dovish rhetoric, and one that may keep the Fed leaning on the hawkish side by keeping all options open in July. From an FX perspective, next week's FOMC meeting could be the opportunity to recover some lost ground. We cannot exclude the possibility that markets will position ahead of the meeting by closing some freshly-built speculative dollar shorts, which could help close the short-term USD undervaluation gap against the euro. Today, some housing data and MBA mortgage applications will be in focus and we still see room for some marginal dollar recovery.

One pair that remains overvalued despite recent USD-negative swings is USD/JPY, and we have been observing fresh weakness in the yen during the late US session and throughout the Asian session following dovish comments by Bank of Japan Governor Kazuo Ueda. With a little over a week to go before the BoJ rate announcement, Ueda said it would take a shift in the assessment to achieve its inflation targets in order to change the ultra-accommodative monetary policy stance. We should note that these remarks by Ueda are quite in line with his recent efforts to carefully manage expectations on the dovish side. We don't necessarily see indications that would significantly lower the chances of a policy shift in July. As noted by Ueda in recent comments, the new projections will remain the key factor next week. Market reaction has likely been heightened by the proximity to the meeting.

Not too far from Japan (relatively speaking), New Zealand saw the release of second-quarter inflation overnight. Headline CPI slowed from 6.7% to 6.0% year-on-year, slightly above the 5.9% consensus but still below the bank's 6.1% forecast. One important caveat: non-tradeable inflation (watched closely by the Reserve Bank of New Zealand) slowed less than the bank's forecasts, and the RBNZ-issued core inflation gauge remained unchanged from the first to second quarter at 5.8% YoY. Markets now price in 50-60% chance of a hike by November, which looks about right in our view, even though NZD's near-term outlook remains much more driven by external factors.

Francesco Pesole

EUR: Reports of a dovish ECB tilt

Just as the European Central Bank quiet period begins ahead of next week's policy meeting, a media report published yesterday hinted at an ongoing shift in the Governing Council towards a softer tone when it comes to near-term policy guidance. The report suggests that members are unlikely to repeat the recent strong guidance for the following meeting, and should refrain from committing to a hike or pause in September – effectively reverting to actual data-dependency. We would not be shocked to see this happen. We have heard a more moderate tone by some of the ECB's most prominent hawks lately, and the ever-deteriorating eurozone activity outlook is definitely clashing against stubbornly hawkish rhetoric despite signs of sticky core inflation.

Still, markets appear reluctant to move on speculation and are probably looking back at the recent history of Lagarde's hawkish press conferences. For now, they've preferred to keep expectations close to two rate hikes (43bp) as EUR/USD has held above 1.1200 thanks to the dollar's still softish momentum. We still see room for the overvalued EUR/USD (in the short-term) to correct lower before the end of the week, with a move back to the 1.1150/1.1170 region as a first step.

Francesco Pesole

GBP: Good news on inflation, bad news for the pound

Lately, we have been pointing at the pound's vulnerable position. Markets' aggressive tightening expectations required data to offer no hints of abating price pressures and an overstretched positioning (on the long-end). It appeared that some long positions had been scaled back already ahead of this morning's key CPI release, with the pound underperforming in the G10 space yesterday.

Looking at the June figures released this morning, there is finally some encouraging news for the Bank of England. Headline inflation slid back below 7.9% (below consensus), illustrating a 0.4% MoM increase which has been the slowest seen since early 2022. We know that the BoE is mostly focused on service inflation, and there was good news here too – a decline from 7.4% to 7.2%, contrary to the BoE's expectations.

The question now is whether this is enough to tilt the balance to a 25bp hike in August. We are inclined to think so, even though it remains a close call. The post-CPI Sonia curve looks significantly changed, with 36bp priced in for August and 90bp to the peak, which marks a huge 55bp shift since last week. In FX, the pound is under pressure, down around 0.70% against the dollar. We suspect there is more room to fall in GBP/USD, especially if our expectations for some dollar support into the FOMC prove to be correct. A move to the 1.2800 area in Cable looks possible even before the BoE meeting. EUR/GBP has spiked, but we suspect markets may like some bullish narrative on the euro side beyond the 0.8700 level, and that may not come just yet if the ECB turns fully data-dependent and the eurozone outlook remains lacklustre at best.

Francesco Pesole

CZK: Lost in translation

Today's calendar in the CEE region doesn't have much to offer. In the Czech Republic, PPI numbers will be released as the last interesting print before the August Czech National Bank (CNB) meeting. PPI has been in deflationary territory for some time, and the more interesting part of the print may be agricultural producer prices. These have been indicating a significant drop in food prices for some time, which should show up in the CPI in the near term as well. Next week, Thursday starts the blackout period and we can expect more active board members in the media these days. While the market is pricing in roughly 120bp of cuts in CNB rates this year, we believe the central bank wants to see much more before the first cut and will wait until November with the risk of delaying until the first quarter of next year to be sure inflation hits the 2% target. We therefore expect the governor to try to fight market expectations again at the August meeting.

In the meantime, yesterday's comments for the budget committee in parliament on expectations of a weaker koruna pushed EUR/CZK from 23.750 to 23.850, with the end of the CNB's FX quasi-commitment in sight. We believe the meaning was lost in translation, but this is not good news for the koruna. Given favourable global conditions, we believe the weakening of the CZK was just yesterday's story, however further weakness could push the CNB to be more hawkish and delay rate cuts even further.

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