

FX Daily: Time for a break above 1.10 in EUR/USD

EUR/USD was rejected at the 1.100 resistance overnight, but unless US core CPI beats the 0.2% month-on-month consensus today (not our base case), the conditions for a decisive and sustainable move above 1.100 are in place. Elsewhere, the RBNZ surprisingly cut rates and even discussed a 50bp move, while a UK CPI miss might not matter much for the BoE



⬇️ USD: We don't expect any CPI upside surprise

Global risk sentiment got a lift from a soft US PPI print yesterday, as the final demand index came in at 0.1% month-on-month (consensus 0.2%) and the measure excluding food and energy was flat in July (consensus 0.2%).

PPI isn't historically a huge data release for markets as it does not have great predictive power for the CPI, but it recently received more scrutiny as about a third of the PPI components feed through into the core PCE – the Federal Reserve's preferred measure of inflation. Our US economist believes yesterday's PPI points to a 0.2% or lower MoM reading in the core PCE, which is consistent with the 2% year-on-year target and should allow the Fed to start cutting rates in September. On this topic,

we have published a [report](#) outlining three scenarios for Fed easing along with the market implications.

We have been bearish on the dollar of late and generally optimistic on sentiment stabilising, and a benign US CPI print, in our view, could clear the path for more risk-on/dollar-off trading into the core PCE release on 30 August and jobs figures on 6 September. In the middle, the Jackson Hole Symposium (22-24 August) may well be the occasion for Fed Chair Jerome Powell to prepare markets for a 50bp cut in September.

Back to today's July CPI report, expectations are for 0.2% MoM in both core and headline inflation. That would mark a re-acceleration from June's 0.1%, but not enough to cause the Fed concern. We are now accustomed to the fact that market reaction will be driven by decimal points, although even a print closer to 0.24% MoM may not generate much disappointment in markets given the positive news for PPI (and in turn for PCE) and the general feeling that jobs data is now more important, as long as monthly core CPI doesn't blow up again.

In terms of FX reaction, EUR/USD had an approximate 0.4-0.5% positive reaction in the 30 minutes following the past two inflation reports. On both occasions, MoM core CPI came in 0.1% below consensus. In May (April report), core CPI was in line with consensus at 0.3% but the dollar still traded on the soft side right after the release. We believe this is a reasonable expectation for today too.

We have repeatedly pointed out how the dollar has traded on the strong side compared to underlying rate differentials in multiple pairs, perhaps on the back of some pre-CPI defensive positioning. We think a consensus 0.2% MoM core print can clear those positions and favour a sustainable USD decline. We expect DXY to break below the 102.2 recent lows in the coming days.

In the rest of G10, the Kiwi dollar took a hit overnight from the Reserve Bank of New Zealand's 25bp rate cut. We admitted this was a very close call even if we were in line with consensus in favouring a hold, but we were a bit surprised by how much the RBNZ focus shifted from inflation to growth – especially given the Bank's remit recently changed to target only inflation. The biggest issue for NZD wasn't necessarily the cut itself, but more Governor Adrienne Orr's comment that a 50bp cut was discussed. Updated rate projections were not too dovish, signalling around 50bp of further reductions this year – but markets are leaning on the dovish side and pricing in 75bp (i.e. 50bp and 25bp at the next two meetings). We remain positive on NZD due to the external environment, but the divergence in policy communication clearly means AUD looks healthier in the region at the moment.

Francesco Pesole

EUR: Ready for a break higher

We see the uptick in EUR/USD into the upper half of the 1.09-1.10 range as the start of a longer-lasting upward trend. As discussed in August's [FX Talking](#), we target a move to 1.12 in the near term on the back of a tighter rate spread and stabilising risk sentiment.

Today's US CPI could prompt EUR/USD to make a decisive break above 1.100. Last week, the pair printed very briefly above 1.10 before rapidly dropping back to 1.0950. As discussed above, that might have been due to markets being reluctant to short the dollar aggressively before the July PPI and CPI reports. We expect the CPI hurdle to be cleared without losses today.

Interestingly, the euro wasn't held back by the dismal ZEW survey for Germany yesterday, another signal that soft eurozone activity is probably priced in. Incidentally, sticky inflation in the eurozone does not really allow markets to price in more than 75bp of cuts by the European Central Bank by year-end. Arguably, even 75bp looks too dovish given the latest data.

In the rest of Europe, Sweden released inflation figures for July this morning. Core CPI inflation slowed from 2.3% to 2.2% YoY versus expectations for 2.1%, but that shouldn't prevent the Riksbank from cutting rates by another 25bp next week. Our call for the remainder of the year is 75bp of easing including next week's cut, but risks are unarguably skewed to 100bp, which is what the market is pricing in.

Francesco Pesole

GBP: CPI miss might not mean September cut

Sterling is dropping this morning after the release of the UK July inflation report, which showed below-expectation prints across the board. Headline CPI re-accelerated less than expected to 2.2%, but the biggest news was the larger drop in services inflation from 5.7% to 5.2% (consensus was 5.5%, Bank of England forecast 5.6%). Core inflation also decelerated meaningfully from 3.5% to 3.3%.

Whether this changes the picture for the BoE is an open question. Our UK economist notes that the services CPI miss was largely due to a correction in hotel prices after they surged in June. Remember that the BoE overlooked some volatile components like this one when they cut rates earlier this month, and a core services inflation measure (stripped out of those components) was actually unchanged in July. There is therefore a chance that the MPC may not put great emphasis on this downside surprise.

But until policymakers actually comment on this and perhaps tame any enthusiasm for larger easing, markets may be inclined to price in more cuts into the Sonia curve, also given the external pressure from the dovish repricing in Fed expectations.

All in all, this morning's inflation figures still help our EUR/GBP bullish call, and we continue to see the pair as a preferable channel to play BoE-related GBP weakness as opposed to GBP/USD, where some dollar softness can still offer support. A return above 0.860 in EUR/GBP looks warranted.

Francesco Pesole

CEE: Room for further gains shrinks but there is still some

This morning, we received Romania's 2Q GDP numbers, which posted growth of 0.8% year-on-year, below market expectations (2.3% YoY). Later today we will also see the same numbers from Poland where we expect a 2.0% acceleration to 2.8% YoY, a tenth above market expectations. This should confirm that a continued economic recovery is underway in Poland, with industrial output posting positive annual growth following five quarters of decline. Also in Poland, the final inflation numbers for July will be published, which should confirm 4.2% YoY and we will see the core numbers here on Friday.

FX in the CEE region saw another leg of the rally yesterday with the biggest gains in the zloty and forint this time. Although the space for gains is shrinking, we still see room for more across the board here. EUR/PLN fell the most across the region yesterday and we think the PLN rally is

outpacing the market a bit. While we agree with the direction, yesterday's move was probably too much in our view. On the other hand, we think HUF has still a clear path for further gains closer to 390 EUR/HUF. EUR/CZK probably needs a clearer signal from the central bank that the current dovish expectations are too far away for a further move lower.

Frantisek Taborsky

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.