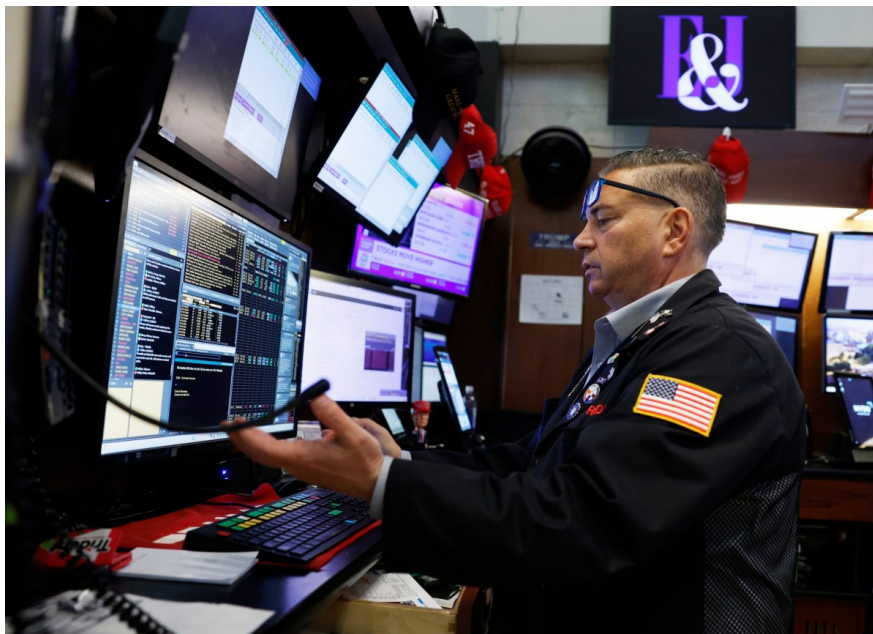


## FX Daily: Time to take tariffs more seriously?

Markets' defiant approach to tariff news will be tested in the coming days as the risk of no trade deals before the 1 August deadline rises. The consensus view is probably that the dollar can lose more ground on a higher average US tariff rate, but the euro's ability to benefit from it may depend on whether the EU gets sucked into a major tit-for-tat escalation



The market's defiant approach to tariffs may be tested soon

### ➔ USD: Tariffs are creeping back

The dollar began the week under pressure, despite the absence of a clear catalyst. Long-dated Treasury yields, which have once again regained a positive correlation with the dollar, continued to decline, but not at a faster pace than EU bond yields. The recent strength in EUR/USD since the weekend appears less driven by rate differentials and more by lower yields signalling a defensive reallocation in response to growing concerns over a no-trade-deal outcome ahead of the 1 August deadline. The dollar's weakness suggests its safe-haven status has not been restored, with markets maintaining a preference for European currencies in the context of tariff-related uncertainty.

Unwinding of USD/JPY longs may also be weighing on the dollar at a broader level. Here, our view is that the yen's rebound may be a fluke, as Prime Minister Shigeru Ishiba's position remains fragile, even if he manages to secure a trade deal with the US. Pressure from other parties to push through some expansionary fiscal measures is unlikely to fade, and that's what has unnerved long-dated JGBs. Beyond the 'buy the rumour sell the fact' initial reaction, the bond market still looks vulnerable.

The US data calendar is quite light. Yesterday's leading index for June declined by 0.3% in line with expectations, and today we'll see two manufacturing indicators from the Philadelphia and Richmond Fed. The market impact should be limited.

There is a case for the FX market to start responding more actively to tariff-related headlines. The defiant approach seen in the past few weeks may start to weaken with just over a week until the 1 August deadline. While we still like the chances of a USD rebound from here thanks to hawkish Fed repricing, negative developments on the tariff front could adversely impact the DXY.

*Francesco Pesole*

## ➔ EUR: Finding fresh support

CFTC data shows net long positioning on EUR/USD at 15.6% of open interest since 15 July. That is the highest since January 2024, but still a relatively contained figure considering the pair is trading almost 10% above early-2024 levels. CFTC figures isolate speculative positioning, signalling that capital and hedging flows are playing a bigger role in the dollar's weakness.

Speculation on a potential no-deal scenario in US-EU trade negotiations is gathering pace. Reports indicate that some EU countries are pushing for retaliatory measures as they see the chances of a trade deal faltering. The Trump administration has shown little tolerance for retaliatory measures, and there is a risk this could spiral (even if temporarily) into a tit-for-tat tariff escalation. The euro's ability to maintain preference over the dollar amid tariff tensions will depend on the extent of any escalation and whether the EU emerges as a relative loser while other countries secure significant deals with the US.

Currently, the euro is not facing domestic tariff-related pressure, and markets are not pricing in a more dovish ECB tone ahead of Thursday's meeting; the next cut remains expected only in December.

We do not see sufficient bullish momentum to push EUR/USD back to the highs of early July (near 1.180), with 1.160 appearing a more appropriate anchor than 1.170, given the risks of further hawkish repricing by the Fed.

*Francesco Pesole*

## ➔ GBP: Non-negligible risk premium

Recent UK data releases have not endorsed the market's tentative speculation on faster Bank of England easing, and two-year GBP swap rates are around 8bp above last week's lows. Expectations are firmly back on a cut in August and one in December – which is also our call.

With the rewidening of the EUR:GBP short-term rate differential in favour of the pound over the past couple of weeks, EUR/GBP's resilience suggests markets are attaching some risk premium to

the pair, which we currently estimate to be 0.8% overvaluation. That may appear contained, but it's already close to the upper bound of the 1.5 standard deviation band that would signal stretched misvaluation.

That GBP risk premium is partly because of the euro's idiosyncratic strength (due to its appeal as a reserve currency) but may also embed some UK budget concerns. Those were fuelled further this morning as the UK unveiled larger borrowing for June (£20.7bn) than expected by the UK fiscal watchdog. There is no meaningful impact on the pound this morning, but that probably raises the chances even further of tax hikes this autumn, a prospect that can keep GBP upside capped.

*Francesco Pesole*

## ➔ CEE: The market will test NBH's hawkishness

Today, in addition to monthly data from Poland, the main event is [the rate decision](#) of the National Bank of Hungary (NBH). Rates are likely to remain unchanged at 6.50% again, with the focus more on the tone of the press conference. June headline inflation was one-tenth above the NBH forecast, but underlying momentum seems to be seeing some gradual improvement. At the same time, the economy continues to surprise on the downside.

The market had already priced out all rate cuts before the summer began, leaving only one cut for the end of the year and three more next year. The central bank is likely to reaffirm its hawkish stance, so we shouldn't expect many new developments. Therefore, we do not see much potential for HUF support here. On the other hand, a surprise may be more likely on the dovish side should the NBH show some bias in that direction given the weaker economy. However, 399-400 EUR/HUF should remain in the days ahead given the absence of a stronger story during the summer in either direction.

Yesterday's industrial data in Poland [once again surprised on the downside](#) and activity here remains subdued. On the other hand, wages surprised to the upside. However, a deeper dive into the headline reading reveals that stronger wage dynamics were mainly due to additional payments in two sectors only. Even though some policymakers point to wage dynamics as an important factor for the monetary policy outlook, we do not think that the high June reading will prevent further rate cuts by the National Bank of Poland (NBP).

The data flow from the real economy is mixed, high wage growth is not broad-based, and the general outlook for CPI inflation is positive. We expect headline inflation to moderate below 3% YoY in July and stabilise around 2.5-3.0% YoY in the months ahead. Overall, we think this combination should allow the NBP to cut rates further by as much as 50bp at the next meeting in September and a further 25bp at the November meeting.

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