FX Daily: Trade deals fuel sense of optimism

Interest rates have moved higher around the world as equity markets rally on a sense of optimism. The biggest factor behind that this week has probably been the US-Japan trade deal and the sense that a US-EU deal is close too. ECB President Christine Lagarde added to that trend yesterday with a more upbeat take on activity. Expect the euro to stay supported

Trade deals and less pessimism are providing support to commodity and emerging market currencies

USD: Dollar environment remains mixed

After a torrid few days, the dollar managed to find a little support yesterday. The domestic data was mildly encouraging in that weekly jobless claims fell again, the service sector pushed the US composite PMI to the highest levels since last December, and June new home sales were not too weak. At the same time, US equity markets continue to nudge to new highs on healthy second-quarter earnings releases and the view that the Federal Reserve will be cutting rates later this year.

On the subject of equities, buy-side surveys suggest that investor cash levels are relatively low and that the community may be close to being fully invested. While a catalyst for an equity correction is not obvious (tariff deadlines in August spark new threats?), it looks like traders will still have to be nimble this summer.

There is not a lot on the US calendar today, but next week is a jam-packed one in the form of the FOMC meeting, June PCE inflation data, tariff deadlines and the July payrolls. We're still of the opinion that the dollar can find a little stability this summer on higher inflation and delayed Fed rate cuts – but clearly this view stands against pervasive dollar pessimism in the market.

DXY could trade a 97.00-97.70 range, but with risks to the downside if a strong German Ifo takes EUR/USD much higher in the European morning.

Chris Turner

EUR: Resilient economy helps the euro

EUR/USD had a good rally during yesterday's European Central Bank press conference after President Christine Lagarde described the economy as resilient and a little better than expected. With inflation on target at 2% and Lagarde frequently repeating the ECB was in a 'good place', investors naturally questioned whether the central bank really needed to take rates into accommodative territory later this year. Two-year EUR swap rates rose about 5bp in the afternoon and gave EUR/USD a 0.5% lift.

More of the same could be due this morning if the German Ifo expectations index continues to advance on the view that business investment is set to rise, helped by the government loosening the purse strings. EUR/USD could retest the 1.1830 high, although this story will help the euro across the board. Here we would pick out EUR/CHF, where a less dovish ECB will be music to the ears of the Swiss National Bank and could help EUR/CHF correct back to the 0.9400 area.

All of the above is contingent on US-EU trade discussions evolving smoothly – with the auto sector, for instance, included in a potential 15% baseline tariff rate.

Chris Turner

GBP: Less dovish ECB helps EUR/GBP

A less dovish ECB has sent EUR/GBP close to 0.87. Some more optimism from the German Ifo today could send EUR/GBP back to the 0.8735 high seen in April. This comes at a time when UK activity is less than impressive. And ECB commentary about a resilient economy and a potential pick up in business investment (should some uncertainty begin to clear) seems to stand in contrast to the fiscally constrained UK economy. On this subject, there is talk that 5 November will be the UK budget day.

We had been looking for EUR/GBP to edge towards 0.88 next year, but a less dovish ECB could bring that target closer. Key to that story will also be eurozone hard data and inflation prints, which our eurozone team still think could lead to a now very underpriced (25%) September ECB rate cut.

Chris Turner

CEE: Small dovish surprise and forint strength

The Central Bank of Turkey delivered a small dovish surprise yesterday with a bigger rate cut of 300bp (vs 250bp expected), but the market was leaning on the dovish side in its expectations, so no big surprise to speak of here. The rate dropped from 46.00% to 43.00%. Despite some improvement in inflation-related risks, the corridor's asymmetric structure remained unchanged – indicating that the CBT aims to retain flexibility in response to potential shocks that might exert unexpected pressure on foreign exchange and reserves. The central bank acknowledged a temporary deterioration in the inflation trend in July and emphasised that future rate decisions will be data-driven and determined meeting-by-meeting.

In summary, recent data supports continued easing given a) improving inflation expectations, b) signs of slowing economic activity, and c) renewed foreign capital inflows and a decline in domestic FX demand, which have bolstered the CBT's foreign exchange reserves. After the easing, real interest rates have remained significantly elevated on both an ex-post and ex-ante basis. We expect the year-end policy rate at 35.0%.

Elsewhere, today's calendar is quiet within the CEE region. Next week should be busier again. We have the first second-quarter GDP data release in the region, key July inflation in Poland (where we see dovish potential), as well as PMIs. We should also hear more from the Czech National Bank, given the start of the blackout period on Thursday.

In the markets yesterday, our attention was on EUR/HUF, which broke 399 after several weeks and closed below 398. We have presented our bearish view on the forint here in recent weeks, so yesterday's move wasn't aligned with our take here. However, we understand the carry argument and lower volatility in the CEE region, which both favour HUF. So, this story seems to be more of a core story. Even so, July inflation, coupled with weaker data, may bring more dovish pricing and pressure on a weaker HUF as we have been discussing for the last three weeks.

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