FX: The markets' love for the dollar

The currency's resilience can be attributed to markets love for the dollar and the strong US economy narrative. But chasing this makes us nervous as there are plenty of warning signs to suggest that this love story could come to an abrupt end

USD: A matter of time until investors turn their attention to a weaker outlook

It's surprising not to see the USD trading weaker following yesterday's relatively soft US CPI report (the breadth of inflation pick-up within the CPI basket was low and limited to a few components). Still, we attribute the currency's resilience to the markets love for the dollar and a strong US economy narrative. But chasing this makes us nervous as there are plenty of warning signs to suggest that this love story could come to an abrupt end.

The big risk that we see is the potential for over-exuberant short-term US GDP growth expectations to adjust lower as investors come to terms with the idea that the US economy is not immune to a global trade war (as one Fed blog points out here) – while the latest round of fiscal stimulus may not be all that it's made out to be (as another Fed study shows here).

And while Fed Chair Powell is seemingly focused on the strong US economy that is here and now, we feel it's only a matter of time before the penny drops, and the USD's support from a hawkish Fed story fades. It may take some leading data to knock the USD off its perch (watch today's Michigan survey).

Read the full Fed study: 'Fiscal policy in good and bad times' here

EUR: June ECB meeting minutes show broad support for dovish tapering

As for the debate over the timing of the first ECB rate hike, ING's Carsten Brzeski notes that something completely unexpected may have to happen for the ECB not to stick to unchanged rates "at least through the summer". EU aficionados should know: the official European summer break always ends in the last week of August – so it's likely that September is the earliest the ECB will hike. This will render the EUR pretty flat for now – at least until sentiment over ECB tightening gains traction.

EUR/CHF broke higher yesterday as investors seemingly gave up on the franc as a haven asset amid a pause in trade war tensions. The breach of the 200-dma may see a broader move towards 1.18 in the absence of a further escalation of trade risks. Any move above 1.1710/15 would support this view.

Read Carsten's full note on the ECB minutes here

GBP: Hawkish BoE implies buy-the-dip bias despite fragile political backdrop

Prime Minister May's much-awaited Brexit White Paper hasn't quite solved the UK's future trading relationship with the EU – but from the pound's perspective, there wasn't anything to take the currency down just yet (P.S. we're not sure why President Trump's off-the-cuff remarks about a hypothetical UK-US free trade deal should have any implications for the price of GBP).

The ball is now in the EU's court, with GBP markets waiting to see if Brussels can work with the UK government's latest proposal. This short-term uncertainty will keep the Bank of England wedged between a rock and hard Brexit place. However, in the absence of any material shocks in next week's UK data releases (which sees the latest labour market, CPI inflation and retail sales reports), we continue to look for an August rate hike under the political status quo. Markets aren't quite convinced, which lends itself to a mildly positive GBP bias in the run-up to the event. Caution will prevail given the fragile political environment.

INR: Only a matter of time before structural weakness kicks in again

USD/INR has failed to push on above the 69.00 level this week amid speculation that the Reserve

Bank of India may have been defending this level (lower oil prices yesterday also helped to ease some of the pressure on the currency). Yet, our Asia Economics team see it only as a matter of time before the rupee moves to a record low – and forecast USD/INR at 71.50 by year-end with the RBI hiking twice in 2H18.

Author

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com