G10 FX Talking: US disinflation opens the door to recovery trades

We are finally seeing the kind of bull market steepening in the US yield curve that marks a new stage in the economic cycle. This is typically positive for activity currencies and bearish for the dollar. The dollar may not fall quite as quickly as late last year, but the direction of travel looks clear. Commodity currencies should be favoured now

Main ING G10 FX forecasts

	EUR/USD		USD/JPY		GBP/USD	
1M	1.11	↓	138.00	→	1.29	↓
3M	1.12	↑	135.00	↓	1.29	↓
6M	1.15	↑	130.00	↓	1.31	→
12M	1.18	↑	120.00	↓	1.34	↑

	EUR/GBP		EUR/CHF		USD/CAD	
1M	0.86	→	0.97	↑	1.30	↓

3M	0.87	↑	0.96	↑	1.29	↓
6M	0.88	↑	0.97	↑	1.27	↓
12M	0.88	↑	1.00	↑	1.25	↓

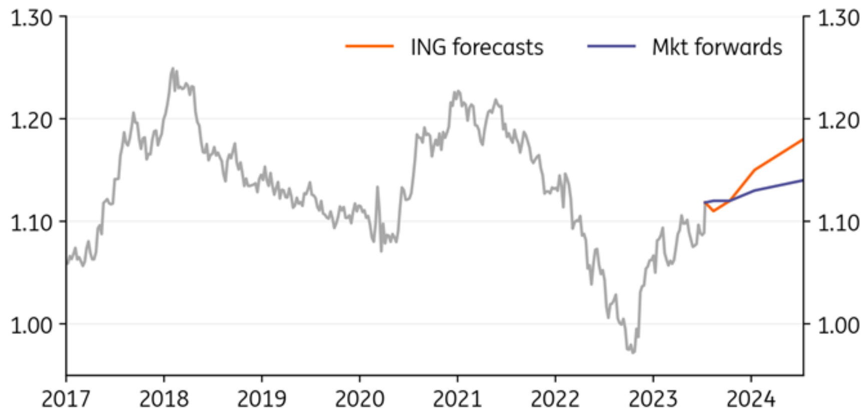
EUR/USD: US disinflation undermines the dollar

	Spot	One month bias	1M	3M	6M	12M
EUR/USD	1.1180	Neutral	1.11	1.12	1.15	1.18

Like many others we have been looking for a weaker dollar in the second half of this year but have been uncertain of timing. There is now a strong case that the softer US June CPI numbers have fired the starting pistol on the cyclical dollar decline. Importantly, we look for the June CPI data to presage a series of softer price data releases this year. The Fed should welcome this news.

Strong signs of US disinflation and bullish steepening of the US yield curve should be a EUR/USD positive. Positioning and Rest Of World growth prospects may not trigger the kind of 8% dollar drop seen last Nov-Dec, but the dollar should still decline.

One last hike from the Fed, plus two more hikes from the European Central Bank should keep rate differentials supportive of EUR/USD.



Source: Refinitiv, ING forecasts

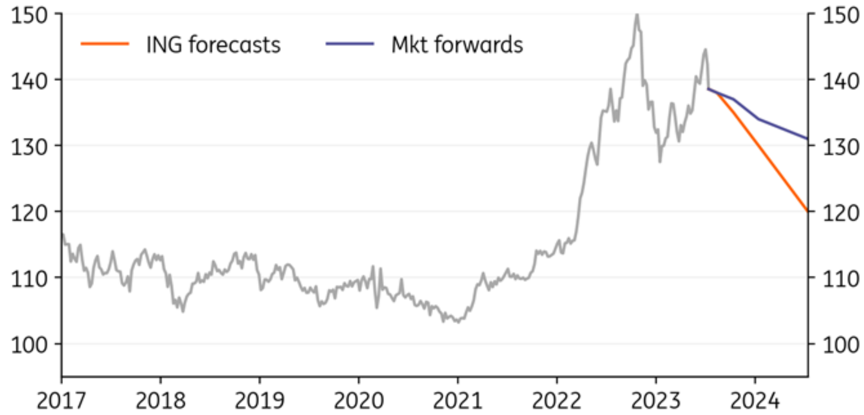
USD/JPY: No need for intervention after all

	Spot	One month bias	1M	3M	6M	12M
USD/JPY	138.56	Neutral	138.00	135.00	130.00	120.00

USD/JPY has reversed sharply from 145 – an area where it looked like Tokyo was readying for FX intervention. Instead, it looks like investor positioning for a possible Bank of Japan policy tweak (28 July) and the softer US inflation data have foregone the need for intervention. A sustained move lower in USD/JPY will require some follow-up – i.e. either from the BoJ or US data.

The reason why speculation has built over the 28 July meeting is that the BoJ also releases its Outlook Report containing new forecasts – i.e. whether the rise in CPI is sustainable.

145 could now prove a solid cap. We target 130 for year-end.



Source: Refinitiv, ING forecasts

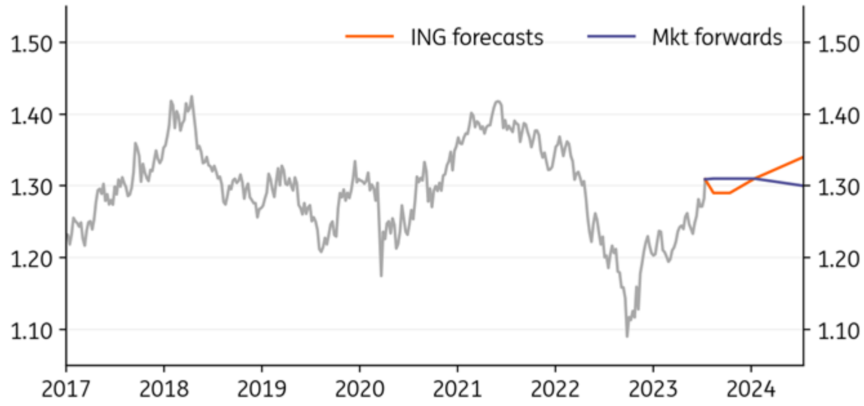
GBP/USD: Hawkish BoE keeps GBP/USD in the ascendancy

	Spot	One month bias	1M	3M	6M	12M
GBP/USD	1.3091	Mildly Bearish	1.29	1.29	1.31	1.34

The Bank of England's (BoE) surprise 50bp rate hike in June caught markets by surprise. That was partly a function of the BoE's policy to avoid much market communication. Some argued that sterling should fall because it made the chances of a UK hard landing all the greater. We argued that very inverted yield curves are often quite positive for G10 currencies.

From here, we can see GBP/USD moving towards the 1.33 area near term. But GBP is subject to the same forces that recently sunk the dollar – e.g. a soft inflation print could hurt.

At the moment we look for two more BoE rate hikes – policy rate to 5.50% – but well below the 6%+ rates priced by the markets.



Source: Refinitiv, ING forecasts

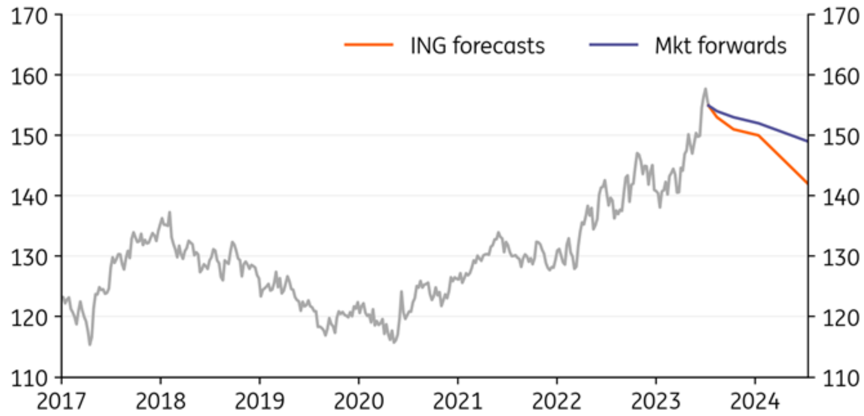
EUR/JPY: Living in a 150+ world

	Spot	One month bias	1M	3M	6M	12M
EUR/JPY	154.9300	Mildly Bearish	153.00	151.00	150.00	142.00

EUR/JPY is correcting off of a high at 158 – but the case for much lower levels is not strong unless we see some strong independent gains in the yen on the back of a Bank of Japan policy shift. Otherwise, the narrative of a soft landing is a mildly positive one for the pro-cyclical EUR/JPY cross.

One left-field risk for the euro is the focus on 2024 fiscal consolidation. Here eurozone finance ministers have faced criticism from the ECB that fiscal policy has been too loose for too long and fuelling inflation. Fiscal consolidation could rein in ECB tightening expectations and limit euro upside in 2024.

The biggest risk for EUR/JPY is probably some emerging financial crisis from the shadow banking sector – in response to high rates.



Source: Refinitiv, ING forecasts

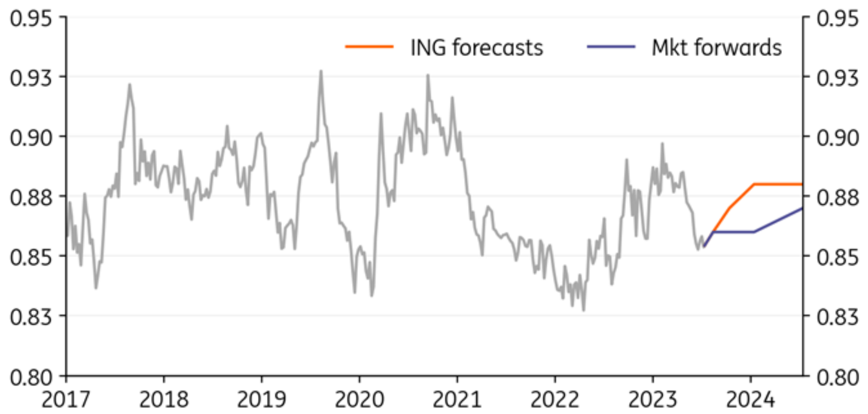
EUR/GBP: 0.8500 could be the new floor

	Spot	One month bias	1M	3M	6M	12M
EUR/GBP	0.8545	Mildly Bullish	0.86	0.87	0.88	0.88

Frustratingly high UK CPI and wage data has kept the market pricing aggressive BoE rate hikes. At some point, as in the US, price data will begin to soften and see the market scale back the amount of BoE tightening expected into 2024. That is why we are still looking for EUR/GBP to trade higher later this year.

For the time being, however, we look for a 25bp BoE hike on 3 August – with the June CPI release on 19 July being a big determinant of whether the BoE hikes 25bp or 50bp.

We find it hard to expect sterling losses on the back of hard-landing fears and expect it will more be the re-assessment of the BoE cycle which will lift EUR/GBP off its lows.



Source: Refinitiv, ING forecasts

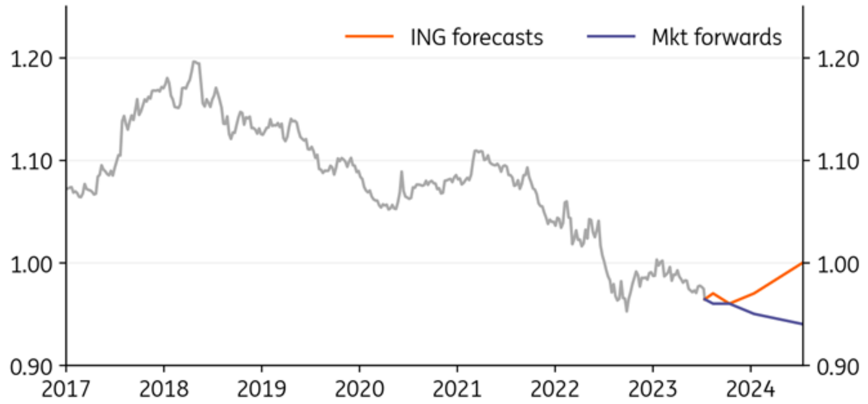
EUR/CHF: Let's not get carried away

	Spot	One month bias	1M	3M	6M	12M
EUR/CHF	0.9643	Neutral	0.97	0.96	0.97	1.00

After a brief rally when the Swiss National Bank (SNB) 'only' hiked 25bp in June, EUR/CHF has come steadily lower. Remember this is a heavily managed cross rate, where the SNB uses FX intervention to guide it lower. The purpose of this is to generate nominal exchange rate strength and keep the real CHF stable.

While our preference has been for a lower EUR/CHF for a while, we would not necessarily chase this move because of developments in USD/CHF. The dollar has around a 20% weight in the CHF trade-weighted basket and the big drop in USD/CHF will be doing the heavy-lifting for the CHF TWI appreciation.

We could see EUR/CHF trading here for a while and only return to 1.00 when global inflation converges back to Swiss levels.



Source: Refinitiv, ING forecasts

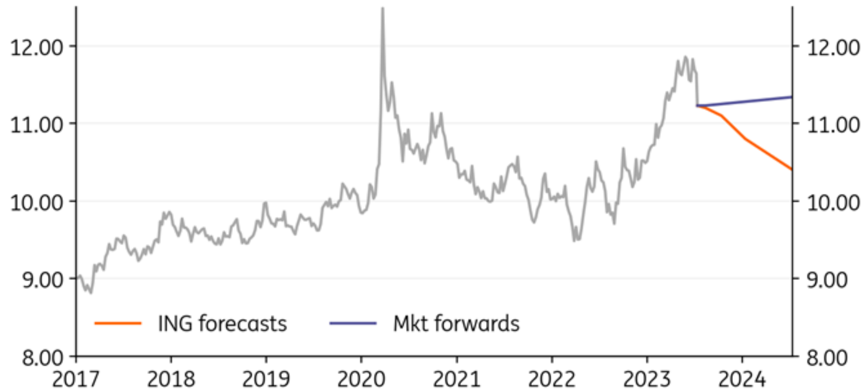
EUR/NOK: Norges Bank bolsters NOK

	Spot	One month bias	1M	3M	6M	12M
EUR/NOK	11.2300	Neutral	11.20	11.10	10.80	10.40

Norges Bank has recently taken its currency support up a few notches: along with signalling two more 25bp hikes to peak, daily FX purchases were trimmed more aggressively in July, from NOK 1.3bn to 1.0bn.

Stickier-than-expected core inflation in Norway, an ultra-tight jobs market and decent growth are all endorsing the recent hawkish escalation by Norges Bank. NB will be satisfied with NOK's recent good performance, but the currency remains around 7% weaker than its 5-year trade-weighted average.

This quarter can still see risk-off-related upside corrections in EUR/NOK, but we now feel more comfortable about our call for a decline below 11.00 in the pair before year-end.



Source: Refinitiv, ING forecasts

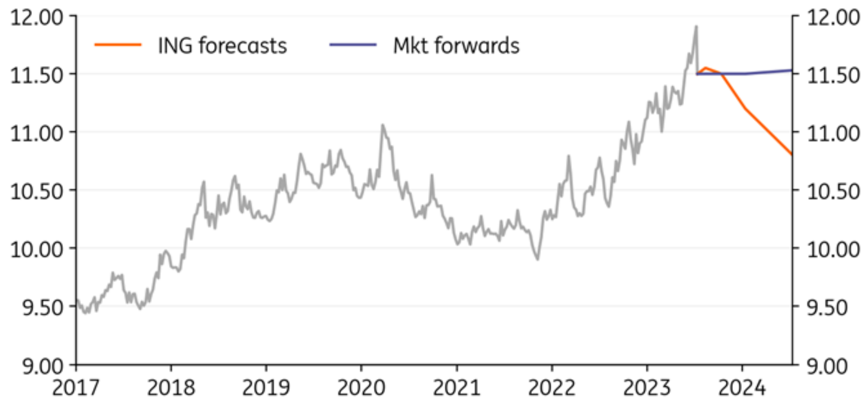
EUR/SEK: Riksbank's back in hawkish mode, but for how long?

	Spot	One month bias	1M	3M	6M	12M
EUR/SEK	11.5000	Neutral	11.55	11.50	11.20	10.80

We had signalled the Riksbank needed to rebuild a hawkish tone to re-establish confidence in SEK and avert more severe sell-offs. In June, the RB offered a solid package to support the krona: a 25bp hike, pledge of another one (likely in September) and an acceleration in quantitative tightening.

EUR/SEK followed the dollar lower lately, but had stayed around all-time highs for some time after the RB meeting, a signal that: a) domestic tail risks remain relevant; b) there are concerns those risks may pose a threat to the sustainability of further tightening.

SEK is undervalued in the medium term and there is still room to recover, but remains the G10 currency with the greatest exposure to real estate pains and domestic risks in general.



Source: Refinitiv, ING forecasts

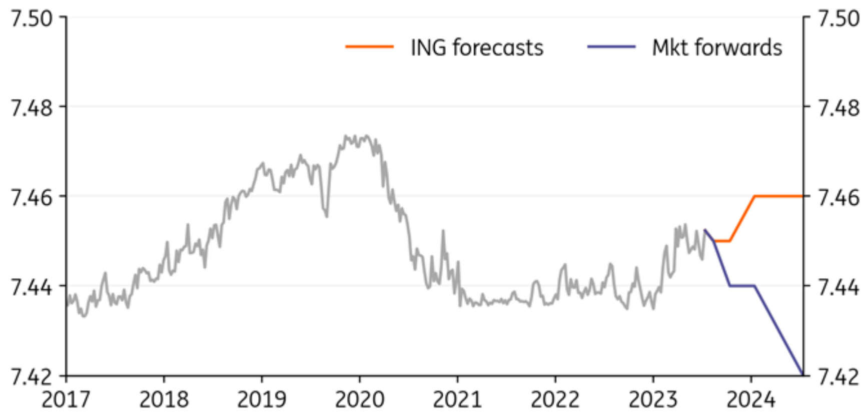
EUR/DKK: One last hike in Denmark

	Spot	One month bias	1M	3M	6M	12M
EUR/DKK	7.4524	Neutral	7.45	7.45	7.46	7.46

Danmarks Nationalbank refrained from intervening in the currency market for a fifth consecutive month in June.

EUR/DKK has climbed steadily in July after a short-lived dip below 7.4460 on 30 June, and it seems quite likely that DN can keep stirring away from FX intervention and continue to follow the ECB's pace of tightening.

We expect the DN to follow the ECB with a 25bp hike in September. In line with our call for a higher EUR/USD, we expect EUR/DKK to keep inching higher and round up to 7.46 around the turn of the year.



Source: Refinitiv, ING forecasts

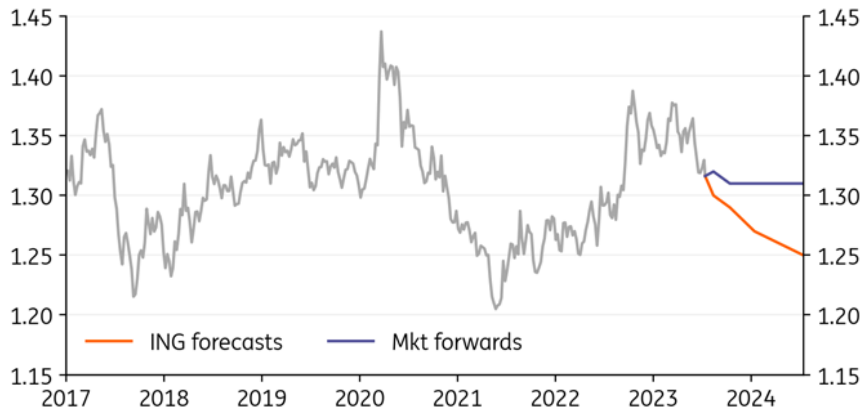
USD/CAD: Loonie affected by the US as much as by Canada

	Spot	One month bias	1M	3M	6M	12M
USD/CAD	1.3162	Mildly Bearish	1.30	1.29	1.27	1.25

The Bank of Canada resumed tightening with two hikes in June and July, and we cannot exclude another increase in September. However, the softer June US CPI means that there is less external pressure to hike as chances of a Fed move have declined.

CAD remains quite tied to the domestic US story, and therefore to the USD itself. Should we see a fully-fledged risk-on rally on the back of a clear softening in US data, expect CAD underperformance compared to other pro-cyclicals.

A more conservative scenario, where markets have to “hold their horses” on the USD decline/Fed peak story for a bit longer can make CAD stand out. In all cases, the attractive volatility-adjusted carry means USD/CAD can hit 1.25-1.27 by mid-2024.



Source: Refinitiv, ING forecasts

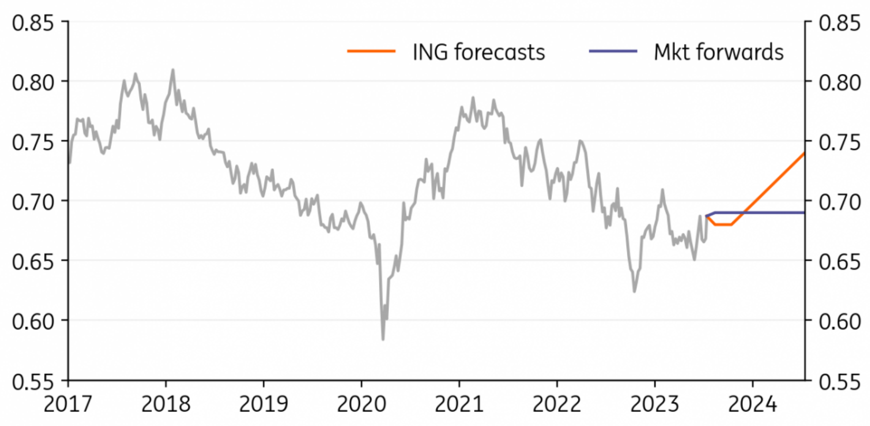
AUD/USD: A bullish "pocket" may emerge in September

	Spot	One month bias	1M	3M	6M	12M
AUD/USD	0.6872	Neutral	0.68	0.68	0.70	0.74

The dovish repricing of Reserve Bank of Australia rate expectations has followed that of the Fed and risk-on environment, leaving AUD/USD stronger.

We could see a bullish "pocket" for the pair in September, when Australian CPI readings could clearly show the impact of large electricity tariff increases due in July and force an RBA hike while the Fed holds on an improved inflation outlook.

The AUD swap curve prices in 14bp to a peak, and the strict data-dependent approach by the RBA could leave more room for tightening speculation. China's underwhelming growth story may still cap gains, but there is room for improvement thanks to Beijing's added stimulus. We target 0.72 in first quarter 2024.



Source: Refinitiv, ING forecasts

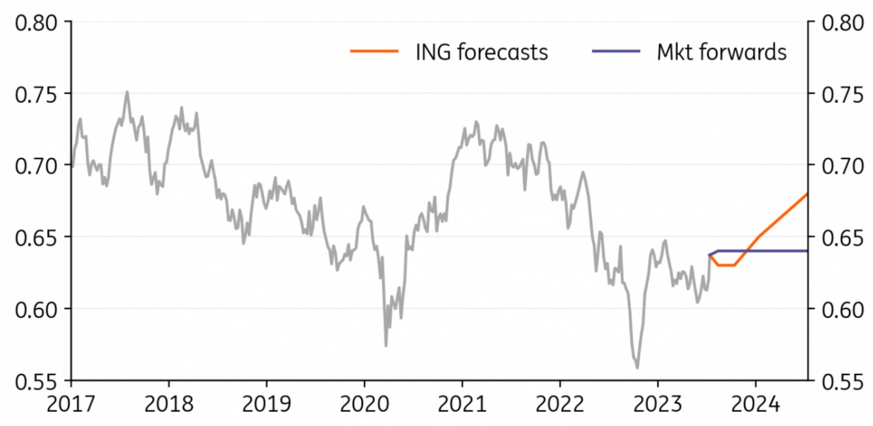
NZD/USD: RBNZ inflation estimates might be too conservative

	Spot	One month bias	1M	3M	6M	12M
NZD/USD	0.6371	Neutral	0.63	0.63	0.65	0.68

The Reserve Bank of New Zealand kept its tone largely unchanged at its July meeting, still signalling that rates need to remain at restrictive territory for longer but without opening the door to more hikes if needed.

In practice, the Bank's expectations to keep rates on hold rely on a set of forecasts for inflation based on assumptions on the impact of government spending, migration and severe weather events that might prove too conservative.

We see non-negligible risks of a resumption of rate hikes in New Zealand before the end of the year. That could allow some advantage for NZD over close peers like AUD and other high-beta currencies around the turn of the year.



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Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com