

The dollar's ungracious decline

White House political setbacks are starting to bite for the dollar



The dollar: What's worrying us

Markets have all but priced out any hopes of US fiscal stimulus coming through in 2017 and the narrative – if anything – seems to be that this is more of a 2018 story. But what's concerning to us is the negative term premium on the US 10Y yield and somewhat lower 5Y5Y inflation breakeven, both of which suggest that we have firmly returned to the status quo 'lowflation' world that we had been well accustomed to prior to last year's US presidential elections.

For sure, the White House wants to shift attention to its tax reform agenda following the failure to repeal and replace Obamacare.

Today sees the House Budget Committee voting on its FY18 budget proposal, which could mark the start of the GOP's tax policy overhaul. While the process will undoubtedly be long and arduous, small steps towards what some may see as a 'dead in the water' tax reform bill could draw a line under the recent USD-selling theme in markets. We're seeing DXY (US Dollar Index) support around 94.00

The euro: Focus shifts to Draghi

Media reports ahead of Thursday's ECB meeting suggest the central bank's staff are working on various ways to begin the QE taper process, although there remains "limited appetite" within the Governing Council to signal a material shift in policy bias. This seems about right to us, though it may come as a bit of a disappointment to EUR bulls potentially hoping for a hawkish surprise.

The yen: Yield curve attention

A Bank of Japan policy decision on Thursday is unlikely to see any major surprises despite the pickup in domestic political pressures and noise around the limited success of Abenomics. Though GDP projections may be revised a touch higher, another downward revision in the CPI profile will reinforce the difficulties faced by policymakers in achieving the 2% inflation target. Particular attention should be paid to commentary surrounding the BoJ's Yield Curve Control (YCC) policy; the central bank was forced to offer unlimited JGB purchases earlier this month (July 7) in order to preserve the implicit +/-0.1% band around the 0% 10-year yield target. Such operations will become the norm if yield curves around the world begin to steepen and we expect BoJ officials to express the same desire to keep the JGB curve under control. On paper, BoJ policy continuity should be JPY negative.

The Aussie dollar: Front-running markets?

Talk of a 3.5% neutral rate in the July meeting minutes was enough for the Reserve Bank of Australia to catch a bit of the current hawkish market contagion. 2-year AGB yields moved back towards the 1.9% level last seen in mid-March, taking the AUD\$ up with it.

We doubt whether there was any explicit intention from the RBA to send a clear policy signal via the latest minutes.

Any near-term hike remains contingent on a pickup in domestic price pressures. With inflation playing a key role in the RBA's policy reaction function, 2Q CPI data next week (26 July) will be critical for markets. Any disinflationary signs – as witnessed in neighbours New Zealand this week – could trigger a dovish reassessment in markets. Ahead of this, there is now even greater focus on RBA Deputy Governor Debelle's speech on Friday – which is aptly called "Global Influences on Domestic Monetary Policy". It may well be time for the central bank to roll out its full jawboning toolkit given the trade-weighted AUD\$ is close to breaching a key multi-year resistance level.