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FX

US playing with fire over China trade

Washington's policy of seemingly encouraging capital outflows from China is a dangerous one. The risk is that the underperformance of Chinese and Asian equities spreads across the Pacific



USD: The renminbi looks now to be another battleground in the trade war

The dollar continues to perform reasonably well and there's a late cycle feeling starting to come through in the US story. The US economic surprise index has recently crossed into negative territory (having been positive since last October), while prices continue to push higher. Indeed, [the data highlight this week](#) should be US CPI hitting a new cycle high of 3% year-on-year. Further bearish US yield curve flattening therefore looks likely, which should be dollar positive against activity currencies and emerging markets. We'd also say Washington's policy of seemingly encouraging capital outflows from China is a dangerous one. President Trump's National Economic Council advisor Larry Kudlow described China as a 'lousy investment' on Friday and it seems quite clear that this [US Administration will enjoy watching China trying to contain USD/CNY near 7.00](#). The risk is that the underperformance of Chinese and Asian equities spreads across the Pacific. For the time being, this looks like a risk Trump is prepared to take. With not many attractive alternatives internationally, expect the US dollar index to press the 95.55/65 highs.

EUR: Soggy

EUR/USD price action remains poor and today's release of German factory goods for June, -4% month-on-month, bodes ill for tomorrow's industrial production release. EUR/USD looks headed down to the 1.1500/1510 area, which is big support but could be broken in thin summer markets. Elsewhere, [we are in the minority](#) looking for no change in Romania's central bank policy today, while most are looking for a hike. Unchanged policy should help secure the lower end of EUR/RON's 4.60/4.70 trading range.

GBP: Friday's 2Q18 GDP is the UK highlight

The pound is holding its own against the euro but succumbing to dollar strength. Expect cable to be dragged lower by EUR/USD through the week, but [potentially receive](#) a reprieve should Friday's 2Q18 UK GDP data surprise on the upside.

AUD: RBA may play it cool given political uncertainties at home and abroad

In addition to CNY dynamics, the Reserve bank of Australia meeting will be the focus for the Australian dollar over the next 24 hours. The data flow has been mixed since the July meeting – with stronger jobs growth offset by a miss in 2Q CPI inflation. The central bank may also acknowledge recent political developments – and what may be a period of domestic political uncertainty ahead of early 2019 elections. The tail risk is that officials choose to cite two-way risks to policy – which may see markets sharply re-pricing RBA policy expectations (a 25 basis point hike is fully priced in for August 2019). We also get the RBA's latest quarterly economic projections (Friday). There's a risk that trade war noise and a dovish RBA sees AUD/USD move below the 0.73 support.

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