USD: Only thing inflating is the downside risks

US CPI miss could weigh on the 90% market odds of a Dec Fed hike

Source: iStock

USD: Important tests

In what will be a pivotal test for the prospects of a December Fed rate hike, today's CPI data also comes at a time when there is mounting evidence pointing to a more structural low inflation problem in the US economy. Looking through the short-term erratic factors, it is pretty difficult to find a composite measure of US prices that has on average seen 2% annual inflation since the 2007-08 crisis. In fact, former Fed Chair Ben Bernanke has recently noted that the level of core PCE – the central bank's other preferred inflation measure – remains 4.5% lower than where it would have been had the Fed been successful in meeting its 2% target since the post-GFC era.

It's therefore no surprise to see current FOMC members like Williams and Evans talking about potential price-level targeting in the future. For markets, the message of structurally low US inflation is being heard loud and clear – with the US yield curve continuing to exert a flattening bias. Headline CPI at 2% today is just noise, while a miss in core CPI will only reinforce the current market dynamics. A miss could be more troubling for the US dollar given that we could see the 90% probability of a Dec Fed hike currently priced into markets fall quite sharply.

EUR: Rekindling its summer love affair with a resurgent EZ economy

Euro markets have rekindled their summer love affair with the story of a cyclical upswing in the Eurozone, with EUR/USD moving back towards 1.18 yesterday – a level that we see as more appropriate. It's no real surprise to us, political noise – and a potential slowdown in the Merkel-Macron European project – might have dampened the strong EZ equity portfolio inflows seen over 2017 (we'll know for sure in the balance of payments data release later this week). But the robust EZ activity data suggests the underlying 'animal spirits' in the economy remain, which in turn could drive EUR/USD towards the 1.20 level heading into year-end.

It's a slight understatement to say that the Scandi FX are 'underperforming', with SEK leading the way, having lost more than 1.7% against the EUR. While one is able to point to a multitude of catalysts – not least weaker Swedish CPI data and falling house prices – the nature of the krona's fall from grace is baffling. Tail risk EUR/SEK breaches 10.00 with Riksbank speakers and jobless data still to come.

GBP: Positive wage surprise could reinstil 2nd BoE rate hike sentiment

While Bank of England Governor Carney may have saved some ink after yesterday's UK inflation figures, the true test for the BoE's hawkish assumptions over the coming months will be the labour market data – not least wage inflation dynamics. It may be a bit too premature to draw any tangible conclusions from today's UK jobs report, but we will need to see wage growth moving in the right direction soon to justify any further UK rate curve steepening (assuming a smooth Brexit). Broadbent and Haldane also speaking. GBP/$ would move above 1.32 on a positive jobs report.

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