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FX Daily: CPI can seal the deal on a Fed hike

The bond market remains in turmoil, but this time the USD is reacting positively. This tentative rebuilding of a USD-back-end yield positive correlation bodes well for the greenback's short-term outlook. We don't think the bar is high for today's CPI to endorse a Fed hike next week. Still, a hawkish ECB means EUR/USD downside risks may be less pronounced

Markets are pricing in 18bp for next week's FOMC meeting

USD: Not a high bar to cement hike bets

Oil prices and global bond yields both surged yesterday. In G10 FX, the reaction looked more like a rates story than an oil story, propagating through the global risk sentiment channel. The high-beta Australian dollar, New Zealand dollar and Norwegian krone led losses on a strong day for the US dollar, while the more defensive sterling and Swiss franc proved relatively resilient.

The dollar is tentatively re-establishing a positive correlation with long-end yields, helped by a smaller-than-expected $6bn Treasury buyback announcement, which ultimately translated into an even smaller $5.19bn operation yesterday. US Treasury Secretary Scott Bessent's reluctance to pick a fight with the bond market through oversized intervention remains a necessary condition for that positive USD-back-end rates correlation to regain its footing.

Pricing for next week's FOMC inched up to 18bp yesterday, buoyed by the oil rally and a modest upward revision to July PPI, while August figures came in exactly on consensus. Today's August CPI release can provide the green light to fully price a September hike with even a marginal upside surprise. Consensus stands at 0.2% month-on-month for core and 0.4% for headline. That is also ING's macro team's expectation, and our assessment is that the acceleration in headline inflation would be enough to tilt the balance towards a hike despite still-benign core dynamics.

The picture becomes more nuanced in the event of a downside surprise. Federal Reserve Chair Kevin Warsh set a high bar for incoming data to overturn the hawkish narrative, but Christopher Waller later suggested no hike would be needed if inflation continued to improve through August. Oil may prove the deciding factor, having rallied around 15% since then. A softer CPI print could weigh on the dollar, but may not be enough to push September hike pricing below 50%, a level we suspect would be sufficient to bring any unconvinced FOMC members on board.

We continue to see upside potential for the dollar. The yen rally has stalled and is no longer exerting a negative spillover effect on USD. Developments in the Gulf leave the balance of risks skewed towards higher oil prices, while stress in bond markets is increasingly bleeding into risk assets. That combination should favour a defensive rotation back into the dollar. DXY 100.0 is starting to look less like a stretch target and more like a destination.

Francesco Pesole

EUR: Hawkish ECB reduces downside risks for now

The European Central Bank delivered a hawkish hike yesterday. Inflation projections were revised higher across the forecast horizon, with headline and core CPI seen at 2.1% and 2.3%, respectively, in 2028. Taken at face value, those forecasts already pointed to further tightening. ECB President Christine Lagarde's press conference added to that impression, and the customary late-afternoon tip to the media removed any lingering doubt: ECB officials expect more tightening, with October firmly in play.

From a rate and FX perspective, however, this meeting was pivotal for the short-term outlook regardless of whether the ECB ultimately delivers another hike this year. The key takeaway is that it effectively gave markets the green light to preserve what is proving to be an almost uncapped correlation between oil prices and rate expectations. Around 85bp is now priced in for July, a roughly 25bp jump compared to pre-meeting.

For that reason, we have trimmed some conviction from our 1.150 EUR/USD call. Even so, while downside risks may now look less acute, they have not disappeared. Our focus remains on the broader risk backdrop this week and on an increasingly likely Fed hike next week, when it may be the dollar's turn to receive a bullish boost from its central bank.

Francesco Pesole

GBP: Good GDP not a game changer for BoE

Gilts took another blow yesterday, underperforming European peers. The 10-year is now eyeing 5.5%, and the 30-year is very close to 6.0%. Sterling held up well yesterday, confirming this was a purely externally driven move in gilts (which simply have higher beta to US Treasuries) and not caused by heightened fiscal concerns.

Chancellor John Healey's pledge to budget discipline is working in that sense. But it equally highlights how limited the room for any pro-growth government measure is. That, among other things, sits at odds with markets' mammoth bets on monetary tightening: 48bp by year-end, 110bp by July. Our baseline is still that the Bank of England won't hike at all, leaving sterling in front of a potential cliff-edge dovish repricing.

UK GDP surprised to the upside this morning, rising 0.4% MoM after June's strong 0.3% gain. Around half the increase came from IT, continuing a familiar trend. With IT accounting for roughly 7% of the economy but contributing a third of the UK's 1.5% annual growth rate, there may be an AI story emerging here. GBP is a tad stronger on the back of that, but these monthly growth prints have not had much impact on BoE decisions.

We continue to see upside room for EUR/GBP and downside for GBP/USD, with 4Q targets of 0.87 and 1.33.

Francesco Pesole

CEE: NBP confirms dovish stance and open door to more zloty weakness

Romanian inflation fell from 8.2% to 6.2% in August, lower than the market expected. The decline mainly reflects a base effect from last year's VAT increase under the government's fiscal consolidation programme. Encouragingly, monthly inflation also slowed from 0.6% in July to 0.2% in August. Turkey will publish inflation expectations later today, after the Central Bank of Turkey kept rates unchanged at 37% yesterday, as expected. We expect the first rate cut in 4Q26, followed by two 100bp moves, allowing more time to assess the recent resumption of liquidity auctions.

The National Bank of Poland delivered no surprises yesterday, while the governor remained dovish relative to peers, market pricing and the global backdrop. Although he acknowledged the recent rise in inflation, he sees no need to adjust rates, potentially until mid-next year, when weaker GDP growth should begin to ease price pressures.

EUR/PLN rebounded to 4.320-4.330, in line with yesterday's range, as dovish repricing narrowed the rate differential. We see scope for a further move towards 4.330-4.340 today. Rates are edging only modestly, with energy prices still driving the market. Delayed rate hikes remain the baseline, and a dovish tone should steepen the curve further, even though Poland already has the steepest curve in emerging markets.

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