FX: Higher eurozone inflation vs political risks

Eurozone CPI data today should call into question the current ultra-accommodative ECB stance. But Italian politics will limit the euro's advance

EUR: Spiking eurozone CPI- a headache for the ECB

Following the meaningful upside surprise to German and Spanish May CPI (both headline numbers surprised by 0.3% vs market expectations, with German CPI at 2.2%), our economists now expect today's eurozone CPI to be at 1.8% year on year, with a risk of 1.9%. This should further call into question the current ultra-accommodative ECB monetary set-up. That said, we expect the potentially strong reading to have a lower positive effect on the euro than would normally be the case given the negative effect of Italian politics on the eurozone bond market. This is because the recent BTP sell-off and a degree of contagion in other peripheral bond markets argue for some ECB caution (at least for now) and against any premature signal of the exit from the QE / depo rate hikes. The latest speculation that the Lega party may consider shifting the previous (eurosceptic) Finance Minister candidate Paolo Savona to the foreign ministry job instead may be seen as marginally positive for the euro today.

USD: Focus shifts to US deadline on tariffs

With Italian risk easing (though from the very high levels – as per the violent reaction in BTPs earlier in the week) and risk assets stabilising, the safe-haven dollar should lack a tailwind today. The focus now turns to the US deadline on EU steel and aluminium tariffs (Friday) and the subsequent risk of escalating trade wards (as the EU said it would retaliate).

CAD: Data to confirm the ongoing recovery

Today's Q1 GDP from Canada should confirm the ongoing recovery in the data of past months and be positive for the Canadian dollar, with the USD/CAD likely moving towards 1.2800. If data stays on track and we see signs of progress in Nafta negotiations, then two Bank of Canada rate hikes in the second half of the year remain on track. This was apparent in Wednesday's upbeat BoC statement with more optimistic language suggesting that tightening may not be far away (see the BoC Review).

TRY: More near-term gains ahead

The Turkish lira is staging an impressive recovery (following its sell-off in previous weeks). Near-term, if the general risk environment does not deteriorate, we expect USD/TRY to break below the 4.40 level and even converge towards 4.30 if the central bank delivers a rate hike at its 7 June meeting. While TRY remains meaningfully undervalued against USD (around 27% based on our medium-term BEER model), we don't expect USD/TRY to return towards the 4.00 level given uncertainty about the post-election policy mix.