FX Daily: A key day for debt-limit negotiations

President Biden and Speaker McCarthy are expected to hold another round of key debt ceiling negotiations today. Some are eyeing this as the last real chance to break the impasse, and given the high risk that no tangible progress is made, upside risks for safe havens (USD and JPY) are elevated today. In the UK, a small decline in wage growth is hitting the pound

Republican Speaker of the House Kevin McCarthy is expected to meet with President Biden today to discuss the debt limit

USD: Last real chance to make progress on the debt ceiling?

The dollar has started the week on the soft side as risk sentiment enjoyed some stabilisation and the FX market followed a playbook risk on dynamics, with safe havens under pressure and commodity currencies strengthening. Within this last group, we are keeping a close eye on AUD this week. The Reserve Bank of Australia (RBA) minutes opened the door to more tightening if necessary, and tomorrow we'll see the first quarter wage price index in Australia, which is expected to rise from 3.3% to 3.6% year-on-year. Any upside surprise may prompt some bets on further tightening by the RBA, and offer some support to AUD: at the moment, markets are not expecting any more hikes. On Thursday, April employment figures will also be released and could confirm a still very tight jobs market.

Back to the US, this should be another pivotal day in Washington for debt ceiling negotiations, with President Joe Biden expected to meet Speaker of the House Kevin McCarthy. While Biden expressed some optimism during the weekend, McCarthy said yesterday that the two sides were still far apart after staff-level talks. He also said that a deal should probably be reached by the end of this week to have a realistic timeline to pass it in both houses. Biden is still scheduled to leave for the G7 meeting in Japan tomorrow, and the White House has so far said there are no plans to curtail the trip for the debt ceiling impasse.

Should we see no progress towards a debt-limit deal today, we could definitely see markets price a greater deal of the US defaulting on its debt. The potentially very negative spill-over into risk sentiment and money markets means that the upside risks for the dollar and the yen are quite significant in such a scenario.

On the data side, retail sales and industrial production will be in focus in the US today. Strong auto sales should have helped lift retail sales in April, but outside of this component, credit card figures point to very modest growth on most items. Industrial production should be held back by lower energy prices limiting the upside for oil and gas extraction. Finally, we'll hear from FOMC members Loretta Mester, Michael Barr, John Williams, Austan Goolsbee and Lorie Logan. Yesterday, Neel Kashkari tried to push a hawkish rhetoric forward, suggesting the Fed probably has more work to do in its inflation battle.

Francesco Pesole

EUR: Watch the pivotal 1.0800 level

This morning, we'll have the only potential market-moving data release out of the eurozone this week: the German ZEW surveys. Consensus is leaning towards a pessimistic read, with the expectations index falling again below zero and the "current situation" index declining from -32.5 to -37.0.

Still, the market impact shouldn't be very material barring a sizeable deviation from consensus. On the ECB side, President Christine Lagarde will participate in an event this afternoon but may not touch upon monetary policy. EUR/USD should remain primarily driven by the USD leg and the US debt-limit saga: we see 1.0800 as the key benchmark support, and a break below that level would probably signal a significant deterioration in market sentiment.

Francesco Pesole

GBP: Start of longer-lasting rise in EUR/GBP

After last month's unexpected surge in the level of UK average pay, the growth rate on a monthly basis slowed once again. Averaging out recent volatility, the change over the past three months relative to the month before was 6.3% annualised, still too elevated, but lower than what we had seen throughout most of 2022. Incidentally, Bank of England surveys suggest that wage growth has peaked.

With the BoE having put a lot of weight on this release, as well as the next CPI print, the chances of a pause at the June meeting have slightly increased. The price action in the pound this morning is mirroring this: EURGBP has broken back above 0.8700 and we think there is still ample upside room as further BoE tightening is priced out of the Sonia curve.

Francesco Pesole

ZAR: Fracturing along geopolitical lines

After last year's Russian invasion of Ukraine, the fear in FX markets was always that currency trends could fracture by geopolitical groupings. For example, outside of the Russian ruble, would the currencies of the other BRICS nations be treated differently by international investors? The neutrality on the war expressed by the likes of Brazil, India and South Africa was certainly noted, but events took a decisive turn in South Africa last week.

Here, the US ambassador to South Africa accused the country of shipping arms (or allowing the shipment of arms) to Russia last December. USD/ZAR traded to a new record high on the news, with investors fearful that South Africa could lose access to various US trade incentives. The US ambassador has since backtracked on those comments – although it is unclear whether the accusation still stands.

It will probably be hard to put this particular genie back in the bottle anytime soon. And even though we think a broad dollar bear trend will carry USD/ZAR lower later this year, in the nearer term – a febrile environment suggests USD/ZAR may challenge 20.00.

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