FX Daily: Bittersweet French election result for the euro

A hung parliament was widely expected in France, but the surprise win by the left-wing coalition may cause market concern ahead of coalition talks. Still, Macron's party coming in second may offer some balance and limit the rewidening in French bond spreads. The euro should still be a laggard in our view. In the US, Powell and CPI are the highlights this week

USD: Inflation and Powell in focus this week

The dollar is modestly stronger out of the weekend as a surprise win of the left-wing alliance in the French second-round legislative elections sent European currencies lower and fuelled some safe-haven demand, with the Japanese yen and Swiss franc rising. We discuss the French vote in detail in the EUR section below.

This week will be a hot one for US macro, with the CPI report for June out on Thursday. We expect the core print at 0.2% month-on-month, in line with consensus, which should be enough to keep markets betting on a September rate cut, which is now 83% (19bp) priced in.

We are also seeing the pricing for total easing in 2024 starting to inch above 50bp again after Friday's jobs report saw a slightly above-consensus payroll print (206k), but -111k of net revisions for the two previous months and unemployment rising from 4.0% to 4.1%. As discussed here, about three-fourths of hiring was in health care and government, and private payrolls undershot expectations. There is a clear weakening trend emerging in the US jobs market and that will, in our view, push an FOMC that wants to avoid unnecessary economic pain to cut three times this year, starting in September.

This week also sees Federal Reserve Chair Powell's testimony to Congress (Tuesday-Wednesday). We stick to our view that if any surprising message emerges from Powell's communication, it will be on the dovish side after an excessively hawkish revision in the June Dot Plot projections.

All in all, we expect the macro story to keep pointing to a dollar decline, but political developments in the eurozone and the US mean that only a few currencies can benefit from it, and that may not include the euro. By extension, the downside risks for the euro-heavy DXY index may be relatively limited. Today's US data calendar is rather quiet, and there are no scheduled FOMC speakers.

Francesco Pesole

EUR: Markets still assessing French election result

The second round of parliamentary elections delivered a surprise result. While it was widely projected that Marine Le Pen's Rassemblement National (RN) would fall short of a majority, the left-wing alliance Nouveau Front Populaire (NFP) unexpectedly won more seats (182) than any other party. President Emmanuel Macron's centrist group came in second with 163 seats and the RN alliance secured 143. This means a hung parliament and two main scenarios: difficult coalition talks or a technocratic government.

The positive market reaction after the first round, which had seen an RN victory, gave an indication that investors were more comfortable with the far right than with the far left, which is perceived as a greater danger to the already fragile French fiscal position. One of the leaders of the NFP, Jean-Luc Melenchon said the NFP plans to strictly implement its programme, which includes an increase in public spending to support social measures including higher minimum wages and an unwinding of Macron's reform that increased the retirement age.

Those fiscal concerns are probably behind the euro trading around 0.2% below its Friday close at 1.0820 after having tested 1.0800 last night. We are waiting for the bond markets to open and will closely monitor OAT-Bund 10-year spread – now at 65bp. Our rates team still sees some rewidening risks as a hung parliament will struggle to deliver any fiscal consolidation and there are some risks related to a potential left-wing government. But the 80bp area could be the limit given the centrist group came in second, offering some balance and potentially thwarting spending plans. Quite intuitively, markets will favour a technocratic government as opposed to an NFP-led coalition.

From an FX perspective, there are lingering risks for the euro moving on, and we continue to see the common currency as a likely laggard in the G10 space in an environment that can still support pro-cyclical currencies on the back of softening US data.

The absence of market-moving data releases in the eurozone this week and the European Central Bank about to enter the quiet period ahead of its 18 July meeting will contribute to making the coming days all about French political developments. We think EUR/USD can trade below 1.08 on the back of that before US macro developments take over.

Francesco Pesole

GBP: BoE speakers are back

Markets are monitoring the first week of Keir Starmer as UK Prime Minister following an uneventful election day for sterling and gilts. Our UK economist James Smith takes a deep dive into British fiscal issues and what the new government can do to avert a cut in spending without higher taxes via tweaks to the fiscal rules.

We doubt that fiscal prospects will have an impact on the pound just yet, while developments in French politics, US macro and Bank of England rate expectations will remain the largest GBP drivers. BoE officials are due to start speaking publicly again following a quiet period before the election, with hawkish external member Jonathan Haskel delivering remarks today, and Huw Pill and Catherine Mann (another hawk) speaking on Wednesday.

The UK data calendar includes May GDP (Thursday) but is relatively quiet before next week's June inflation report. We see some downside risks for GBP/USD this week given the spillover from EU political risk, which however means that a return in EUR/GBP steadily above 0.8500 has been delayed further.

Francesco Pesole

CEE: Inflation numbers should please central bankers

We will see most of this week's events in the region in the first half. The Czech market is back after Friday's holiday. So with a delay, we will see Czech National Bank minutes from the June meeting when the central bank cut rates by 50bp to 4.75%. The minutes will show the names of the two members voting for the 25bp step and a discussion of the next rate cut. On the economic front, we'll see industrial production data in the Czech Republic and final GDP data in Romania was released this morning. Inflation for July will be released tomorrow in Hungary. We expect the headline rate to fall from 4.0% to 3.7% year-on-year, below market expectations. However, core inflation remains higher at 4.0%. We will also see inflation in the Czech Republic on Wednesday. Here, we expect a decline from 2.6% to 2.5% YoY, slightly above the market expectation, and a further decline in core inflation. On Friday, industrial production and labour market data will be released.

Conditions for CEE FX have generally improved in recent days and we could see some further gains across the board. EUR/USD is around the highest level since mid-June and so far this has been ignored by CEE FX, especially in EUR/CZK. At the same time, core rates have rallied more than CEE rates and the rate differential has risen especially in Poland's zloty. And generally, the market remains in risk-on mode after the US jobs data. On the other hand, inflation numbers in the Czech Republic and Hungary are more on the dovish side for central banks and could be negative for FX. So the picture is quite mixed but unless we see more significant surprises we should still be stronger in CEE FX at the end of the week.

Frantisek Taborsky

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.