FX Daily: Calmer conditions ahead of the long weekend

FX markets are settling into calmer conditions ahead of the long weekend in the US and the UK. While G7 finance officials reaffirmed their commitment to free-floating exchange rates at this week's meeting, they did share their concern over 'unsustainable macro imbalances'—perhaps a nod to US concerns over its trade deficit. The calendar is light today

G7 finance ministers have been meeting in Canada this week

USD: No change in FX language at the G7 meeting

Earlier this week, we speculated over the low probability, high impact event of a change in FX language in this week's closing statement from the G7 meeting of Finance Ministers and Central Bank governors in Canada. In the end, the statement said very little about FX apart from reaffirming commitment to its 2017 statement on FX - namely favouring free floating exchange rates and avoiding competitive devaluations, However, the statement did seem to convey much of the US concern over unfair trade practices which resulted in concern over 'unsustainable macro imbalances'. We read that phrase as the G7 looking at China's large trade surplus, although the global investor base could equally be looking at the US trade and budget deficits, too.

So, if the US Treasury avoided the blunt instrument of a G7 statement change to weaken the dollar, where does that leave us? Concerns remain over US Treasuries this summer, as evidenced by the US 10-year swap spread still trading wide at 55bp. We're also following the high-frequency data when it comes to foreign official holdings of US Treasuries. Fed custody holdings data suggest these fell $10bn in the week to Wednesday, marking a $30bn drop since the start of April. We're all really waiting for the April US TIC data, released mid-June, which will tell us which country sold what in April.

Ahead of long weekends in the US and UK, realised FX volatility continues to drift lower. However, traded or expected volatility remains relatively high for EUR/USD and USD/JPY. Here, one-month trade levels remain above 8% and 11%, respectively, suggesting investors are not comfortable pricing pre-'Liberation Day' levels of volatility just yet.

DXY may well trade slightly offered and well within a 99.20-100.20 range today.

Chris Turner

EUR: June ECB rate cut looks on the cards

The release yesterday of ECB minutes and ECB commentary seems to squarely point to a 25bp ECB rate cut in June. That would take the deposit rate to 2.00%. That's fully priced by the markets, as is a further 25bp rate cut in December. Yesterday's flash PMI data for May appears to support that pricing, with some worrying declines in the services component. Here, it clearly looks as though uncertainty is weighing on activity, and there will be much focus on EU-US trade negotiations, which should pick up steam next month.

We think the euro is continuing to benefit from being the most liquid alternative to the dollar. There is also evidence that portfolio re-allocation is helping the euro. Earlier this week, March eurozone Balance of Payments data showed that eurozone residents repatriated EUR40bn of foreign equity positions in March—the largest inflow since September 2022. And the equity portfolio flow account looks pretty healthy for the euro right now.

For today, we're focusing on two things on the eurozone calendar. ECB Chief Economist, Philip Lane, speaks at 1030CET in Florence... let's see what he has to say about disinflation. And at 11CET, we'll get the latest update from the ECB on negotiated wages. The last ECB negotiated wage tracker, released in April, pointed to wage growth at 4.8% in 2024 and 3.1% in 2025. Any drop in the 2025 figure could be a very mild EUR/USD negative today.

Expect EUR/USD to trade well within a 1.1280-1.1380 range today.

Chris Turner

JPY: A July BoJ hike is underpriced

We think the chances of a Bank of Japan hike in July are very much underpriced. The market attaches around a 10% probability to such an outcome. Last night's release of April CPI data should worry the BoJ enough to prompt a 25bp hike in our opinion. And with the dollar staying relatively weak, USD/JPY will likely meet good selling interest should it make it back to the 145 area.

Chris Turner

Asian FX: Staying bid

$/Asia is staying reasonably offered. It is not clear whether this is a function of a bullish reassessment of Chinese and global demand on signs that the US and China are looking for a negotiated trade settlement. Or is it some view that the US Treasury will get its way with stronger currencies for Asian trading partners? After all, about two-thirds of the US trade deficits in goods sit with Asia. With US-Asian trade deals very much up for discussion over the coming months, $/Asia can stay under pressure.

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