FX Daily: Day of the deficits

Ahead of long weekends in the US and the UK, the focus today could well be on US deficits. Here the Biden administration is expected to unveil its full budget proposals consisting of $1trn+ annual budget deficits for a decade. And we should also see a record monthly US trade deficit for April. With $ hedging costs continuing to fall, the $ should stay soft.

USD: Deficits are bad news for the dollar

To be honest the market has yet to focus on the legacy of the pandemic in terms of deficits. And as we have noted recently, driving FX markets have been re-opening stories and whether central banks feel comfortable in discussing monetary normalization plans. Yet today should see some focus on US deficits. Apparently, the Biden administration will release fully costed budget plans at 1330ET today, including $6trn in federal spending for FY22, annual budget deficits for a decade in excess of $1.3trn and a US debt to GDP rising to 117%. These extended budget deficits seem quite large, given they already include the Democrats' proposals for tax increases. The news on the size of the spending prompted a rally in industrial metals yesterday.

In addition to the fiscal side, today sees the advanced US trade data for April. A monthly record deficit of $92bn is expected as the US consumption boom plays out. Large twin US deficits could be easily financed if the dollar offered attractive relative returns. But at this stage in the recovery cycle, there is an increasing number of attractive alternatives overseas. Additionally, US money markets are awash with cash, US banks placed a record $485bn in the Fed's overnight reverse repo facility yesterday (at 0%) and dollar hedging costs are falling to the cheapest levels since 2015.

While month-end flows (watch out for the 17CET WMR fixing) may impact the dollar later, we think the dollar trend continues lower. Supporting this continues to be the move in $/Asia, where USD/CNH is lower despite the PBOC saying yesterday that it would not use Yuan strength to counter commodity price rises. What to make of the fact that USD/CNH has still moved lower? Well, it suggests the PBOC is increasingly taking a 'hands-off' attitude to the Renminbi and perhaps will allow some market-driven appreciation. A return to the 6.25 low seen in 2018 before Trump started trade wars will be the market's target now.

Today we'll also see some PCE spending and deflator data for April, but that looks unlikely to move markets. We would expect to see this little corrective bounce in DXY stall in the 90.20/25 area. A close above that would not be part of the short-term plan.

EUR: Foreign buyers not welcomed by the ECB

The ECB doves seem to have done a good job of putting the kibosh on any idea of PEPP tapering at the June 10th meeting. Will the hawks acquiesce? The market thinks so. The softening in EUR long-end rates has taken a little steam out of the EUR/USD rally, but we expect it to stay supported. Driving that interest in the EUR looks to be foreign equity investors. Eurozone equity ETFs listed in the US have seen a definite pick-up in buying interest over recent weeks - the strongest interest since 2017. The story of equity investors rotating to 'value' stocks in Europe should be a supportive one for EUR/USD this summer.

No doubt the ECB will not welcome this interest in the EUR - hence comments from ECB doves such as the Banque de France's Villeroy de Galhau that the ECB will be even more patient than the Fed. For today, we should see some further encouraging Eurozone business confidence readings for May. As we write, EUR/USD is pressing some good intra-day support at 1.2160/2170, which we would like to hold in a move back to 1.2250/70.

GBP: Price action says a lot

GBP has performed well over the last 24 hours on the back of comments by BoE dove, Vlieghe. He laid out three scenarios for the path of the UK economy and the BoE's response - yet the market only reacted to the hawkish scenario. That sits with hypersensitivity of the market to monetary normalization stories - as witnessed this week in New Zealand and last week in Hungary and Poland.

News that the full re-opening of the UK economy in June is 'in the balance' may hold GBP back temporarily, though Cable now looks well supported at 1.4100.

SEK: Solid data points unlikely to affect Riksbank’s stance

A strong Economic Tendency Survey reading for May helped push EUR/SEK closer to the 10.10 level yesterday. 1Q GDP and April retail sales (both out this morning) should further support the currency today. Yet, we don’t expect the improving data points to have any immediate spill over into the Riksbank reaction function, with the bank making it clear that it will look through the current spike in CPI and see it as temporary.

While the Riksbank should not offer a helping hand to SEK this year (as opposed the Norges Bank, which should hike at least once – and possibly twice – this year) the unfolding synchronised global recovery from summer onwards should help to push EUR/SEK below 10.00 later this year.

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