

## FX Daily: Debt-limit impasse giving dollar a lifeline

Negotiations on the US debt ceiling have yielded very little progress so far and there is now a growing concern that it might take a market sell-off (in equities and/or money markets) to break the impasse. This would be a very bullish scenario for the dollar in the near term. For now, this story is offering the dollar a floor as CPI figures come into focus



Pictured: The Capitol. President Biden and congressional leaders failed to resolve the impending default crisis at a meeting yesterday

### USD: CPI in focus as debt-limit impasse continues

The impasse over the US debt ceiling increase is emerging as an increasingly short-term supporting factor for the dollar. A meeting between President Biden and Congress Republicans did not yield much progress on a potential agreement, and while Republican leader Mitch McConnell dismissed the risk of a US default, he admitted the negotiations were at a stalemate. For now, a short-term debt-limit extension, which would be the quickest solution, has been ruled out.

The current situation is inevitably weighing on risk sentiment and offering support to the dollar. There is now growing concern that it might actually take a market sell-off (in the equity or money markets) to break the impasse. This would be a scenario where the dollar would get a significant

near-term boost, also considering USD speculative shorts have risen steadily in the past few months, and one of the reasons why we favour a delay in the start of the greenback's downtrend to the third quarter.

In such an unstable risk environment, the US will see the release of the April inflation report today. Our economist's call is aligned with consensus: a 0.4% month-on-month read in core CPI, translating into a marginal deceleration from 5.6% to 5.5%. Headline inflation may stabilise at 5.0% or slightly decelerate to 4.9%. If these are the numbers we see in today's print, we think the Fed will be allowed to leave the door open to a potential revamp of tightening (even though we think the peak has been reached) and most importantly have some support – also offered by strong jobs data – to keep pushing back against rate cut expectations.

All in all, today's inflation may also contribute to putting a floor under the dollar in the near term, even though we remain resolutely bearish on the greenback for the second half of the year.

*Francesco Pesole*

## 📉 EUR: An unusual underperformer

We have not been very used to seeing the euro score towards the bottom of the G10 daily scoresheet without a strong idiosyncratic event lately. After all, the common currency is around 2.5% higher against the dollar this year, and only GBP and CHF have performed better so far this year (in the G10). We attribute yesterday's euro underperformance to some position-squaring: remember that the latest CFTC positioning data indicate that EUR/USD is the most overbought pair in G10, with net-long positions amounting to 22% of open interest, the highest since early 2021.

In terms of domestic news, some ECB hawks have come to the fore in the aftermath of last week's ECB meeting, which probably did offer some hints of a shift to a more neutral stance (especially in the statement). Governing Council member Martins Kazaks hit the headlines by saying that he does not assume rate hikes will end in July, and the de-facto "leader" of the hawkish bloc, Isabel Schnabel, stated that rates will be raised with "full determination until there are signs that core inflation is also falling on a sustained basis". The debate about headline versus core inflation, given the pronounced energy base effect and the resilience of core measures, looks set to be a key leverage point for the hawkish rhetoric within the ECB.

Today, we'll hear from Madis Muller and Mario Centeno, while the euro remains without a clear domestic driver and news from the US will drive most EUR/USD moves. There are lingering downside risks for EUR/USD, which might extend the correction to 1.0900 today.

*Francesco Pesole*

## 📉 GBP: EUR/GBP weakness not very sustainable

The pound showed very good resilience yesterday despite a destabilised risk sentiment and an appreciating dollar. This may boil down to markets holding on to some long GBP positions ahead of the Bank of England announcement tomorrow. Here is [our full preview and scenario analysis](#) ahead of the meeting.

EUR/GBP has now broken below 0.8700, the lowest level since December. A good part of sterling's outperformance over the euro relies on the market's hawkish expectations on the BoE, with 70bp of tightening still priced in this year. In our view, there are good chances this week will mark the

last rate hike of this cycle, and the pound will struggle to hold on to its strength against the euro as its rate advantage gradually erodes. We continue to target 0.90 by year-end.

*Francesco Pesole*

## 📉 NOK: High volatility continues (in both directions)

The Norwegian krone came under pressure yesterday as risk sentiment deteriorated, US debt-limit concerns rose, and the illiquid character (relative to its G10 peers) came back to haunt NOK. This followed a quite sharp correction in EUR/NOK late last week, which was driven by some recovery in commodity prices and possibly some position-squaring effect.

There is also a chance that the very vocal FX protest by Norges Bank around the latest policy meeting yielded its desired effect, albeit with some delay. We still think the chances of a higher terminal rate by Norges Bank have risen and that daily FX purchases will be trimmed more aggressively in June to support NOK. Still, with external headwinds driving the vast majority of NOK's moves, volatility and downside risks will remain elevated for the krone in the near term, and a return to the 11.90 peak in EUR/NOK is a tangible risk. Here is our [latest note on NOK and Norges Bank](#).

*Francesco Pesole*

### Author

#### Francesco Pesole

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

#### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

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