

FX Daily: Dollar probably stays supported into the weekend

Over recent weeks we have been discussing the FX market trade-off between [politics and policy](#). Today is a fine example: dollar-bullish politics on both sides of the Atlantic will be challenged by some dollar-bearish US inflation data. We think the weekend French election risk probably dominates and the dollar stays bid. EMFX also faces some challenges



Last night's presidential debate saw 67% of registered voters awarding the victory to Donald Trump

➔ USD: Everyone expects a soft inflation number today

There is a very strong consensus around a 0.1% month-on-month core PCE deflator for May today. Remember this is the Federal Reserve's preferred measure of inflation and following a 0.2% MoM prior reading should give the Fed confidence to start cutting rates later this year. The market does not fully price in the first Fed rate cut until November and thus there should be room for US short-dated rates to drop as focus shifts more squarely to a September rate cut. US two-year Treasury yields have been consolidating just above 4.70% for the last couple of weeks and a 0.1% MoM core PCE today should be a catalyst for them to break lower and drag the dollar with it.

The challenge, however, is politics. Last night's presidential debate on CNN saw 67% polling

awarding the victory to Donald Trump. Is it too early for these kind of swings to start impacting the dollar? We see a potential Trump administration as more positive for the dollar both via looser fiscal policy and also via a more aggressive trade/tariff environment. Equally, the weekend sees the first round of voting in French elections which could hit the euro - more on that below.

DXY is now edging above 106 helped in part by the unchecked rise in USD/JPY. Here, the market seems reasonably calm. This makes it more difficult for Japanese authorities to intervene. DXY will face downside risks from the US inflation data, but we suspect it will find buyers in the 105.50/60 region as investors will prefer to hold dollars over the weekend.

Chris Turner

📉 EUR: Bracing for the French first round

It looks like investors are already bracing for the outcome of Sunday's first round of French parliamentary elections. The 10-year OAT-Bund sovereign yield spread is trading at a wide 82bp and EUR/USD is drifting back under 1.07. ING's Philippe Ledent previews French elections [here](#). His article serves as a reminder that if a candidate does not secure 50% of the vote in the first round, only the top two candidates go forward to the second round vote on 7 July. Given the polls point toward Marine Le Pen's faction at 35% of the vote, the Leftist coalition at 28% of the vote, and the centre at 20%, President Macron's party looks set for a wipeout in parliament.

The question for the market is whether a Le Pen government looks at the French bond market and starts dropping some of its plans for seemingly unfunded tax cuts - or pushes ahead. Our eurozone team suspects it will be too early for a new government to substantially water down its pre-election pledges and that it may well be a rocky few months into September - when France needs to deliver to Brussels its plans on how it will fix its 5%+ budget deficit. This period suggests a further risk premium can be built into French bonds (OAT-Bund spreads to 120bp?) and into the euro, too.

Ahead of the weekend election, today sees the European Central Bank release its consumer inflation expectations for May. Three-year expectations currently sit at 2.4% and a drop under there - marking the lowest levels since before Russia invaded Ukraine - would add to expectations that the ECB could cut again in September. Currently, the market attaches a 64% probability to such an outcome. Perhaps the ECB will take encouragement from the Riksbank which [yesterday added the possibility of an extra cut in the second half](#).

Today's EUR/USD game plan could see a brief spike to 1.0745/60 on the lunchtime US inflation data, but we would not be surprised to see it end the day back under 1.07 as investors brace for weekend elections.

Elsewhere, the Swiss National Bank releases its first quarter 24 FX intervention data today. We suspect it will show the first FX buying in two years. However, we doubt EUR/CHF holds gains to the 0.9620, possibly 0.9650 area, and see it back at 0.9500 during a hot summer of French politics.

Chris Turner

➡ GBP: Modest upward revisions to first quarter GDP

GBP/USD is edging higher today - helped in part by an upward revision to the first quarter GDP data. Encouragingly, consumption seemed to be the biggest driver here. However, we still forecast the Bank of England will begin cutting rates in August and will start to signal that in speeches once

the 4 July general election has passed.

Somewhat amazingly, UK rates are still priced very similarly to the US. We have a much greater conviction that UK rates will come lower and that sterling will be dragged lower too. GBP/CHF has had a decent bounce off of 1.1200, but we look for the move to stall ahead of 1.1400 and a return to 1.12 this summer.

Chris Turner

📉 EMFX: Losing its shine

Some of the EM high-yielding currencies are still struggling in spite of a relatively benign environment for the carry trade. The Brazilian real has had a poor June as investors see little appetite from the Lula administration to rein in government spending. The Mexican peso has started to weaken again - perhaps because yesterday Banxico implied it wanted to push ahead with easing policy even as the peso wobbles from the threat of constitutional reforms. And in South Africa, delays in forming the new cabinet have investors fretting that the unlikely bedfellows of the ANC and the Democratic Alliance may struggle to work together after all.

Lower US rates may help the EMFX environment today, but we suspect that investors will be pursuing high-yield FX with less enthusiasm this summer. Please look at our latest [FX talking](#) for all our latest forecasts.

Chris Turner

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

Frantisek Taborsky

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

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