

## FX Daily: Dollar skips to the Fed beat

The dollar came off its highs overnight after a couple of Fed speakers suggested the bank could skip a hike at its June meeting. This strategy could buy the Fed a little more time. However, US data and the overnight release of the Fed Beige Book suggest the dollar will hold gains as we head into tomorrow's jobs report. Look out for PMIs and eurozone CPI today



### ➔ USD: We're hearing more of this term 'skip'

Having enjoyed a decent rally on the back of some surprisingly strong JOLTS job opening data, the dollar sold off late yesterday on a couple of Federal Reserve speakers (Patrick Harker and Philip Jefferson) suggesting that the Fed could potentially 'skip' a rate hike at the June meeting - but leave the door open for a July hike. That term 'skip' first entered the Fed lexicon with remarks from Christopher Waller last week and suggests the Fed is indeed starting to use a new communication tool for gracefully ending its tightening cycle.

While that new strategy does provide some flexibility for the Fed, the data will be a key determinant on whether indeed it does skip the June hike. The release of the [Fed's Beige Book](#) last night looked reasonably positive. It was hard to identify any clear signs of slowing activity and consumption was holding up well. Perhaps there were some early signs that pressures in the tight labour market were easing - but nothing to support any recessionary narrative. That suggests this

current dollar dip does not need to run too far.

Ahead of tomorrow's May nonfarm payroll report, today sees the release of ISM Manufacturing, Initial Claims and the ADP employment report. A slightly better external environment - China's small-business PMI was better than expected in May - could see the dollar edge marginally lower were US data to come in on the soft side today. However, we doubt the dollar will go too far ahead of tomorrow's more important jobs and wage data. DXY could trade in a 104.00-104.50 range and if the Fed policy rate could be flatlining after all this summer then expect further interest in the carry trade. Here, USD/JPY could grind back to the 141 area.

Also, look out for weekly US crude inventory data later today. Brent has remained very soft and a large build in inventories could keep it at its lows (weighing on oil-exporting FX) ahead of this weekend's OPEC+ meeting.

*Chris Turner*

## ➔ EUR: Will eurozone core inflation decline much?

Declines this week in German, French and Spanish May inflation data have the market speculating about a soft eurozone flash CPI number today. Consensus expects the headline to drop to 6.3% year-on-year from 7.0% with the core falling to 5.5% from 5.6%. A faster fall in eurozone inflation than in the US would confound a market that had been betting that the greater weight of assets in US inflation would bring that measure lower faster than in the eurozone. Softer European inflation this week has also seen eurozone swap rates drop relative to those in the US. The two-year EUR:USD swap differential has now widened back to levels seen in March - weighing on EUR/USD.

Barring a major surprise in the eurozone CPI data, we can probably see EUR/USD tracing out something like a 1.0650-1.0720 range today - i.e. a holding pattern ahead of tomorrow's NFP data. Bigger picture, however, we reiterate that this 1.05/1.07 area should prove a base for EUR/USD this summer - given that conditions are nowhere near as severe as those that drove EUR/USD so much lower this time last year.

*Chris Turner*

Some idiosyncratic EUR weakness following weaker-than-expected inflation figures in the eurozone put a cap on EUR/SEK and EUR/NOK yesterday. However, both pairs face significant bullish pressure due to the high-beta character of Scandinavian currencies and specific vulnerabilities: the recent dovish turn by Sweden's Riksbank and domestic real estate woes for the krona, and poor liquidity and oil weakness for Norway's krone. May was the first month since October 2022 where NOK outperformed SEK (NOK/SEK rose roughly 2.5%), largely on the back of diverging monetary policy narratives. We think that Norges Bank can still surprise on the hawkish side (especially after a somewhat disappointing FX sales announcement for June) while the Riksbank appears stuck in its dovish communication missteps, and we expect NOK's outperformance over SEK to be the norm in the coming months. Today, the Riksbank also releases its financial stability report. Let's look out for any updates on developments in the commercial real estate sector.

*Francesco Pesole*

## ➔ GBP: Still going strong

Sterling continues to perform well. Markets have scaled back some of the aggressive (110bp) tightening priced in for this year, but not by much. Equally, there had been some speculation that Bank of England hawk, Catherine Mann, could use a speech yesterday to push back against these tightening expectations - as the BoE chose to do last year when the market priced a Bank Rate at 5.50%. True to form, however, Mann warned that UK consumers were using excess pandemic-level savings to fund spending - and that corporates were taking advantage of better pricing power to improve margins.

This leaves the market pricing close to 100bp of tightening this year and has sent EUR/GBP below 0.8600. And sterling now looks like a decent intra-European target currency for the carry trade. Unless eurozone CPI today surprises on the upside to drag eurozone swap rates higher, EUR/GBP looks as though it can drift to the 0.8550 area.

*Chris Turner*

## ⬇️ CEE: European Parliament to vote on Hungary

Today's calendar offers PMI numbers across the region, the second estimate of GDP in Hungary, and the state budget result in the Czech Republic for May. In general, we expect a slight deterioration in industry sentiment across the board. In the Czech Republic, the state budget for April showed the worst result on record which drew a lot of attention and raises questions about government bond issuance for the rest of the year. On the other hand, the government recently unveiled a consolidation package targeting by far the lowest fiscal deficit in the region for next year (1.8% of GDP), which produces mixed feelings overall. Later, the Czech National Bank will decide on changes to the settings of the financial stability instruments. It is very likely that some limits on mortgage lending will be relaxed. A central bank press conference is scheduled for 3.45pm local time.

On the political side, today at 11.00am local time the European Parliament (EP) will vote on a resolution entitled "Breaches of the Rule of Law and fundamental rights in Hungary and frozen EU funds". Some MEPs are protesting against Hungary's EU presidency, which is scheduled for the second half of next year. So potentially we could see negative headlines today linked to the rule of law and EU money.

As a result, we will be watching the Hungarian forint today, which is currently near record highs, and the market positioning is arguably long. Thus, we suspect that any noise around Hungary may spark a forint sell-off closer to 373 EUR/HUF. Moreover, a further decline in EUR/USD threatens the entire region once again, building pressure for weakness across the board. However, at the end of the day, the EP has no legal power in the matter. Thus, we think the market could re-enter the HUF at a later date, benefiting from by far the highest carry within the region.

*Frantisek Taborsky*

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