

## FX Daily: Macron and the euro face a stalemate

The euro appears to be waiting for cues from French coalition talks, with scenarios ranging from a left-wing government to a market-friendly technocrat prime minister. FX volatility has continued to drop in the meantime but EU politics, Powell's testimony today and US CPI on Thursday may revamp it. In New Zealand, the RBNZ should stay quite hawkish



### ➔ USD: Powell takes the stage

The dollar has been modestly stronger since the start of the weekend but there was nothing close to an earthquake in markets following the French election result, and FX volatility has continued to fall from its mid-June peak. One consequence is revamped interest for the high-carry Mexican peso, which appears to be having more inertia for a decisive move below 18.0 compared to late June's failed attempt, largely thanks to the softening in US activity data. US CPI data on Thursday will be the big test for the emerging markets FX bloc, which has been generally supported since the start of July.

Today's highlight is Federal Reserve Chair Jerome Powell's testimony to the Senate, which will be

replicated in the House tomorrow. It won't be easy to extract relevant policy comments amid the often not so relevant questions by policymakers, and the market impact will be concentrated around the release of opening remarks. We stand by our view that if there is any deviation from the recent narrative, it should be on the dovish side, as Powell might see the June Dot Plot revisions as too hawkish and want to fine-tune communication on the back of recent data.

On the data side, we'll keep a close eye on June's NFIB Small Business Optimism index and on the hiring plans index, which tends to lead the month-on-month change in private payrolls by three months. We see DXY hover around 105.00 into the CPI risk event on Thursday, with any dovish surprises from Powell potentially being offset by EU political concerns.

Elsewhere, the Reserve Bank of New Zealand announces policy at 03:00 BST tomorrow and will almost certainly keep rates on hold. As discussed in our [preview](#), we expect no surprises on the dovish side given the lack of data on inflation and employment for the second quarter (to be released in the next month). We see a hawkish RBNZ contributing to an NZD rally this summer.

*Francesco Pesole*

## ➔ EUR: Market patience to be tested

The market has been inundated with all sorts of scenario analysis after the French election resulted in a rather unusual political stalemate in France. Many are looking at precedents in the more coalition-prone Italian politics of the past few years for inspiration. That is not too much of a stretch, especially in the instances of a technocrat prime minister solution to coalition impasses: Mario Monti during the 2011 bond crisis, or Mario Draghi in 2021.

In France, a coalition that includes a technocrat prime minister would likely require the exclusion of the most left-wing factions of the New Popular Front party, and it remains unclear whether this is feasible in terms of parliamentary arithmetics. That would be the most market-friendly scenario in the near term as it would prevent large spending measures, even though a fiscal consolidation in the medium run would remain hardly achievable, spelling trouble for French bonds.

The spectrum of less market-friendly options is rather wide and intricate. For now, it is likely that negotiations will prove anything but easy for President Emmanuel Macron, and markets may grow impatient. A rewidening in the OAT-Bund spread remains a tangible risk, and we see EUR/USD upside capped in the near term.

Interestingly, markets seemed to punish the more high-beta developed European currencies – SEK and NOK – as opposed to the euro yesterday. The former dropped much more than the latter though, and we continue to see upside risks for NOK/SEK beyond the parity line given diverging fundamentals and monetary policy. More in our latest [Scandinavian FX update](#).

*Francesco Pesole*

## ➔ GBP: Waiting for more balanced BoE speakers

Hawkish MPC member Jonathan Haskel was the first to deliver remarks following the Bank of England's quiet period around the election. He unsurprisingly said that he will vote for a hold at his final meeting in August as he highlighted inflation risks stemming from the tight labour market.

That may have helped the pound trade on the strong side for most of the European session

yesterday, but it hardly provides an accurate snapshot of the MPC's consensus. Tomorrow's speech by Chief Economist Huw Pill, who is a more neutral member, should shed a brighter light on the current BoE stance ahead of key CPI data next week.

The calendar is empty in the UK today, and EUR/GBP held up quite well yesterday after the French vote result. We may be seeing some renewed pressure on the pair on the back of a rewidening in EGB spreads, but rate differentials will continue to point up ahead of the August BoE meeting, in our view.

*Francesco Pesole*

## 📌 HUF: Another downside surprise in inflation

This morning, inflation in Hungary for June showed a drop from 4.0% to 3.7%, roughly in line with the central bank's forecast and ours, but two-tenths below market expectations. The June print is the first inflation number after the National Bank of Hungary announced a pause in its rate cutting cycle, so we expect increased market attention. While on paper we do not expect rate cuts in the second half of the year, it is clear that if conditions allow for it, the NBH will not hesitate to use them. The first inflation print opens the door, but the next few months may be more complicated given our expectation of a pick-up in inflation.

Yesterday's budget figures in Hungary showed a further [deterioration](#), but at the same time, the government announced new fiscal tax measures to improve the budget this year and next. In our view, this could cover the fiscal risk we saw earlier and the current official target of a 4.5% of GDP government deficit could be achieved. This is particularly good news for Hungarian government bonds (HGBs) and issuance in the rest of the year, which could slow down given the strong frontloading in the first half of the year. This is also good news for the stability of the HUF, which tends to be hit hard when there are problems on the HGBs side, usually resulting in more HUF weakness.

Yesterday's depreciation of the HUF was triggered more by the announcement of tax changes for banks and the sell-off in the stock market as a result. However, rates were already slowly sliding down yesterday and today's inflation print will very likely increase market bets on rate cuts in second half of the year. And this should result in more HUF weakness.

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