

## FX Daily: French politics can still cap the euro

The euro is trading stronger this morning after the outcome of the first-round French parliamentary elections came in quite close to polls, with a victory for the National Rally. We think this week's US data can push EUR/USD higher, but French politics can still put a cap on the pair this summer. In Sintra, Lagarde and Powell take the stage tomorrow



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### 📌 USD: Data, Powell and Biden

The first round of the French election did not yield any major surprises compared to the latest polls. As we discuss in the EUR section below, the euro is seemingly getting rid of some risk premium, ultimately weighing on the dollar this morning. We still think the dollar can benefit from defensive positioning into and after the 7 July second round vote.

On the other hand, the US macro story is increasingly pointing to a softening in the dollar. The three main data releases this week are the ISM survey results (manufacturing today, services on Wednesday), the FOMC minutes (Wednesday), JOLTS job openings for May (Thursday) and June's jobs report (Friday).

The ISM PMIs are expected to show a marginal improvement in manufacturing – while remaining in

contraction – and a softer services figure, while still in expansion. All in all, there is a chance the surveys won't be adding much more to the activity narrative. Instead, jobs figures should set the undertone for markets outside of the impact of EU political developments until June CPI figures are released on 11 July. Interestingly, consensus is for another drop in JOLTS job openings after the surprise April contraction which hit the dollar. When it comes to the payroll print, jobless claims data and weak business hiring surveys suggest the jobs market is softening, and we don't expect another strong read for June. Consensus is currently at 190k, and there are chances of an even softer print.

Ultimately, we expect jobs figures to support the case for a rate cut in September. As discussed by James Knightley [here](#), the 0.08% month-on-month (rounded to 0.1%) core PCE figure for May and the cooldown in consumer spending are all pointing in that same direction. We don't think the Federal Reserve will want to drive the economy into an unnecessary downturn, and September remains the most likely start date for an easing cycle.

We'll hear what Fed Chair Jerome Powell will have to say about this at Sintra's European Central Bank forum tomorrow. He has generally shown a sanguine tendency when it comes to disinflation, and he may ultimately neutralise the impact of FOMC minutes on Wednesday, which could be more hawkish given the June Dot Plot.

Finally, a lot of focus will remain on US political developments as President Joe Biden faces mounting pressure to step down from the race. Should this happen, the Democratic party committee would decide a new nominee. The favourite would automatically be VP Kamala Harris – who has even lower approval ratings than Biden. California Governor Gavin Newsom is seen as a more likely successor at this stage. That's unlikely to be a smooth process, but with consensus having shifted more in favour of a USD-positive Trump victory after last week's debate, Biden dropping out could be a USD-positive development, especially if Newsom becomes the candidate.

We aren't convinced the peak of French political impact on the FX market is past us, so while we see US macroeconomic data as mostly USD-negative in the coming weeks, we doubt this will translate into a clear-cut dollar decline due to EU political risk. DXY may break below 105.0 on softening US jobs figure and a dovish Powell this week, but may then encounter increasing support below that level.

*Francesco Pesole*

## EUR: Relief, for now

It appears that EUR/USD is getting rid of some political risk premium this morning after preliminary results from the first round of French parliamentary elections came in close to pre-vote polls. Marine Le Pen's National Rally is projected at 34%, followed by the leftist New Popular Front at 29% and President Emmanuel Macron's centrist alliance at 22%. The positive reaction in the euro is, in our view, primarily due to some market relief for the New Popular Front not gaining more than expected.

Still, first round results are not offering much certainty about the composition of the parliament, and the second round scheduled for the next weekend is in fact the big risk event. We'll be monitoring closely the performance of OAT versus the bund today. There is a chance of some tightening in the spread which can help the euro, but our rates team continues to view structurally wider spreads beyond the short term and we doubt the euro will be able to entirely erase political

risk premium this summer.

On the data side, the eurozone calendar's main highlight is the flash CPI estimates for June, released tomorrow. German numbers are due this morning and are expected to show a slowdown from May's 2.4%. Inflation did come down as expected in France and Spain's CPI estimates released on Friday.

The ECB's forum in Sintra runs from today until Wednesday and will offer plenty of discussion on policy and inflation. ECB President Christine Lagarde delivers prepared remarks today and on Wednesday, and participates in a panel with Powell tomorrow. Among other speakers in Sintra, Isabel Schnabel and Philip Lane stand out. On Thursday, June's ECB minutes are released.

Markets should end this week with a slightly clearer picture on the ECB path ahead given CPI data and ECB-speak, but the political factor should remain the main driver for the common currency until next week's second round results in France are out. We think soft US data can help a move above 1.0800, but a return to 1.0900 is a relatively long shot considering risks of rewidening EGB spreads.

*Francesco Pesole*

## **GBP: Uneventful election?**

It is election week in the UK, and the BBC poll tracker puts Labour at 40%, Conservatives at 20%, Reform UK at 16% and Liberal Democrats at 11%. There has, indeed, been very little doubt about a Labour landslide win, so the election should not be a huge event for markets. We suspect that a stronger than expected result by populist/hard-Brexiteer Reform UK is the most tangible risk for some slight adverse reacting in GBP assets.

As widely discussed recently, the chances of the election result deviating the Bank of England policy path are very low, and the pound should continue to rely on external drivers (both in EU politics and US macro) and key domestic data releases. June CPI and jobs report aren't published before 17-18 July, so even if we see expect a cut in August (market pricing 15bp) to hit the pound, the case for a materially stronger EUR/GBP within the next couple of weeks is not very compelling.

*Francesco Pesole*

## **CEE: French election spreads positivity to the EU's eastern flank**

We have a busy week ahead not only on a global level but also for the CEE region. Today, we will see PMIs across the board which should confirm a mixed picture for industry – but hopefully including some signs of improvement. Later today, we will also see the first half government budget result. The National Bank of Poland meets on Wednesday and, in line with the market, we expect rates to remain unchanged at 5.75%. As always, more attention will therefore be on Thursday's press conference. We will also see June inflation in Turkey on Wednesday. We expect a reversal after the peak in May and a drop from 75.4% to 72.5% year-on-year in June. We will also see a central bank decision in Romania on Friday. We expect the National Bank of Romania to leave rates unchanged again at 7.00%, but the consensus preference is for a 25bp rate cut, and it looks like it will be a close call. On Thursday and Friday, we will also see some data prints of industrial production and retail services in Hungary, the Czech Republic and Romania.

While we have a busy calendar in the region, we don't think that prints and central bank data this week will change the picture enough to impact FX all that much. Today will be all about the impact of the French election, and early indications point to weaker CEE FX, especially through higher EUR/USD. Usually, we would see the CZK less vulnerable to the global story vs PLN and especially HUF, but this time we see the CZK in the same group thanks to the Czech National Bank undermining FX with a larger than expected rate cut last week. However, rate differentials fell significantly across the region last week, leaving FX vulnerable to an external shock. On the other hand, today's open indicates positive news coming out of France supporting CEE FX across the board, which should be main story for today.

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