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FX

FX Daily: Glass half empty

Debt-limit negotiations in Washington yielded a more conciliatory tone, but not enough tangible progress to keep markets away from their defensive dollar positions. This may not change for now, and 1.0800 may come under pressure soon in EUR/USD. In Australia, wage growth data were not shockingly high, but may still lead to another RBA hike



President Biden with US Vice President Kamala Harris and Speaker Kevin McCarthy on Tuesday

We have published the May edition of ["FX Talking: The rocky path to a weaker dollar"](#), with all our updated views and forecasts.

USD: Tentative debt-limit progress not enough to lift sentiment

Some slightly encouraging news has emerged from yesterday's high-level meeting between President Biden and Congress Speaker Kevin McCarthy. The two sides have agreed on a new

basis for staff-level negotiations on the debt limit, and Biden has decided to shorten his Asia-Pacific trip to make sure he can secure a deal early enough to give both Houses time to approve it before the 1 June default deadline. Speaker McCarthy said it is possible to get a deal by the end of the week, even though he also mentioned the two sides remained far apart.

Markets are looking at the glass half empty in this situation, as expectations were probably for some more tangible progress towards a deal. In FX, the dollar is seeing a new round of strengthening – in line with our expectations – and we think that there is still room for appreciation until we get clearer indications that the two sides have gotten closer on core issues when it comes to debt-limit negotiations. We still suspect the lingering uncertainty will prompt markets to favour defensive trades, and DXY could extend its rebound to the 103.50/104.00 area by the end of the week.

Data are playing a secondary role at the moment, and today we'll only see the release of some housing numbers for April, which may soften given the decline witnessed in mortgage applications for home purchases. On the Fed side, we'll hear from FOMC members Bostic and Goolsbee.

Francesco Pesole

↓ **EUR: Pressure on 1.0800 coming?**

EUR/USD is coming under pressure again this morning and we keep stressing how 1.0800 is probably a key benchmark level to gauge market sentiment about the US debt-ceiling story. We could see some good support at 1.0800, and a break lower could indicate the FX market moving more seriously to price in a US default.

The domestic story for the euro is not deteriorating materially and the decline is almost entirely driven by the dollar leg, although yesterday's ZEW figures in Germany did send some worrying signals, as discussed by [our economics team here](#). Today, we'll see the final print of the eurozone's CPI figures for April and we'll hear from a plethora of ECB speakers: De Cos, Centeno, Guindos and Rehn.

Francesco Pesole

↓ **GBP: EUR/GBP starting to move in the right direction**

EUR/GBP has started to edge higher and we expect more upside room on the pair on the back of ECB-BoE policy divergence. A slowdown in wage growth was one of the two pieces of information the BoE needed to pause its tightening cycle in June, the second one will be some deceleration in inflation (data out on 24 May).

Our UK economist is calling for a June pause, and given 20bp of tightening are priced into the Sonia curve for June and 40bp in total before the peak, there is ample room for GBP to be hit

by a dovish re-pricing. We still target 0.8900 in EUR/GBP by the summer. There are no market-moving data releases in the UK today.

Francesco Pesole

📉 AUD: Wage growth points to more tightening

Australian wage growth for the first quarter steadied at 0.8% quarter-on-quarter, translating into a 3.7% year-on-year reading. While this is still low compared to other major economies like the US or the UK, [our economics team](#) notes here that 3.7% is still too elevated to be consistent with the Reserve Bank of Australia's 2-3% inflation target. Tomorrow's jobs data will also be key for the next RBA move.

Ultimately, we think this morning's release points to a higher risk that the RBA will have to hike by another 25bp before hitting the peak: this could happen already in June, but a delay is surely possible. The cash rate futures curve is showing little to no expectations of further tightening, with only about 9bp above the current 3.85% rate priced around August/September.

We think AUD can gain some relative advantage against other commodity currencies from an under-priced RBA hike, AUD/NZD upside looks rather attractive in this sense. AUD/USD, instead, could remain vulnerable on the back of the challenging risk environment and USD's good momentum for a little longer. Still, we target 0.73 as the year-end value as a USD decline should materialise in the second half of the year.

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