FX Daily: Inflection point?

ISM employment surveys point to a drop in payrolls, and we see some downside risks given a relatively optimistic 190k consensus. Today could mark the kind of inflection point in the jobs market that the Fed's Mary Daly has discussed, and fuel dovish bets. Elsewhere, the pound was untouched by Labour's well-telegraphed landslide win in the general election

The consensus for US payrolls is 190k in June after a very strong 272k May reading

USD: Room for payroll disappointment

Before headlines on a possible replacement for the US Democratic candidate take centre stage again, the focus will be on the first piece of hard US data for June: US payrolls. The consensus figure is 190k after the very strong 272k May print.

We think the risks are skewed to a softer reading today after the big drop in the employment component of the ISM services index. To see a major repricing in Federal Reserve rate expectations to the dovish side however, we may need to see payrolls slow below 150k, considering the June Fed Dot Plot and rising perceived probability of a Trump win in November work as hawkish counterweights.

Over the summer months, we expect to see evidence that the US labour market is at the kind of inflection point that some Fed members like Mary Daly have referred to. We also think that other upside surprises in payrolls may have an asymmetrical, more contained market impact (compared to downside surprises) after recent comments by Chair Jay Powell suggested the Fed acknowledges that headline figures may overestimate the actual number. This narrative may gain more traction should we see large revisions in the April-May figures today.

We see downside risks for the dollar today, and expect DXY to move below 105.0. A substantial repricing in Fed dovish bets may give some respite to the yen, although we continue to see the likes of Norway's krone, and the Australian and New Zealand dollars as the best-positioned G10 currencies for a US-macro led rally in high-beta FX.

Francesco Pesole

EUR: Rate cut dissent

The minutes of the June European Central Bank meeting, published yesterday, showed some members did not agree with cutting rates. As discussed here, it is increasingly clear that the June move was a consequence of a series of pre-commitments, rather than a strong intent to start an easing cycle. Indeed, the minutes confirm the centrality of data dependency at this stage, with particular focus set to be on wages, whose stickiness is keeping many EBC members on the cautious side when discussing further easing.

At the same time, there appears to be growing confidence in the ECB's staff economic projections by the Governing Council. Those projections remain rather optimistic on disinflation by end-2025, and will in our view justify two more rate cuts by the ECB this year. Market pricing is less dovish, at 38bp.

There is no market-moving economic data in the eurozone today, and EUR/USD will be driven by events in the US. We see some upside room for the pair on the back of US payrolls disappointment potential. While EUR/USD may move to the upper half of the 1.08/1.09 range today, we think the lingering risk of a re-widening in French bond spreads after Sunday's second round election mean the upside remains capped.

Francesco Pesole

GBP: Labour expected triumph materialises

Labour is set to secure a very vast majority in parliament, according to preliminary results. Keir Starmer's party should secure around 410 of the 650 seats, while the Conservatives are projected to lose 247 seats from the previous election and be left with only 118. The Liberal Democrats are projected at 70. Labour's lead is not as large as pre-election polls had suggested, but it makes no difference from a policy perspective given the still huge majority.

The pound did not move much during the night and this morning, a clear signal of how a Labour majority had been fully priced in. We take a first look at what kind of challenges the new government will face in this article. We believe the new chancellor can avert spending cuts thanks to small edits of the fiscal rules and minor tax tweaks. However, it will be complicated to avert a rise in taxation further down the line.

What matters for sterling, however, is mostly the implications for Bank of England policy. And for the moment, there are none. BoE officials should start speaking again next week after a quiet period before the vote. Our view remains that the first cut will come in August, and will be followed by two more in 2024. In line with that, we expect sterling to be a laggard in the summer months.

Francesco Pesole

CEE: Hawkish NBP to be replaced by NBR close call on the start of the cutting cycle

Although we expected a hawkish National Bank of Poland press conference, the governor has raised the bar once again. An inflation forecast well above market expectations for next year and forward guidance of stable rates for all of next year is a lot for the market to digest. The market is pricing in roughly 100bp of rate cuts overall by the end of next year. This suggests a lot of room for repricing despite yesterday's significant move and we believe that less than half of the current pricing could be in play. This gives the front-end decent room for more paying and flattening, with the 2y/5y segment as the best place to be, in our view. EUR/PLN touched 4.280, our level from yesterday's FX Daily and the repricing at the front-end of the curve gives us more room to go lower, with 4.260 as the next stop for us.

Today in the rest of the region we will see more monthly hard data from retail sales and industrial production in Romania and Hungary. The Czech market is closed today due to a public holiday. Later, we should see a decision from the National Bank of Romania. Most of the market surveys expect the cutting cycle to start with a 25bp cut to 6.75%. However, we expect rates to remain unchanged today as in May and the NBR will wait for a new forecast in August. However, it is obvious that it will be a close call. EUR/RON remains untouched, and we do not expect any changes here before the end of this year. The situation may be more interesting in Romanian government bonds (ROMGBs), which have underperformed their CEE peers for most of the year, and a rate cut could give them some impetus to rally. Regardless of the timing of the start of the cutting cycle, however, we see room for rate cuts capped at just two 25bp cuts for this year.

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