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FX Daily: Iran fall-out coming home to roost in EUR/USD

EUR/USD was hit in March on expectations that the stagflationary shock from Iran would resonate more in Europe than the US. The inflationary effects have been plain for all to see, but this week s release of European PMIs warns that the stagnationary effect is just starting to land in Europe. This can curtail ECB tightening expectations and weigh on EUR/USD

It now looks as though we're entering a new bearish phase for EUR/USD

USD: Look out for a Waller speech at 4:00pm CET

The FX market is relatively calm and being gently bounced around by headlines out of Iran. One-month G7 FX implied volatility is near the lows of the year, suggesting the FX market is not priced for any dramatic news trends. The story since mid-May, however, has been the hawkish re-pricing of the Fed cycle and a stronger dollar. The market now prices 20bp of Fed hikes by December.

The Chicago Fed President, Austan Goolsbee, sounded a word of warning yesterday by announcing, "We have a pretty significant inflation problem developing". He is a non-voter this year, but is not typically seen as one of the most hawkish on the Fed. For a better steer on Fed thinking from another centrist, we have a speech from Christopher Waller today at 4:00pm CET. He typically delivers very clear speeches on the economic outlook, and his most recent speech made the case for a prolonged pause after he had voted for a rate cut in January. It is probably too early for him to be speculating over a hike, but this speech could be the biggest market mover on a quiet Friday. The background here is that, now that the US jobs market looks relatively stable, the Fed should be concentrating more on its price mandate.

Today's US data calendar is quite light. Final releases for the University of Michigan Consumer sentiment today will provide an update on inflation expectations at both the one-year and five-to-ten year horizons. Any increase in the medium-term expectations will be important for the Fed.

Expect DXY to remain supported in a 99.00-99.50 range, with upside risks should Waller hint at the need for rate hikes.

Chris Turner

EUR: Activity is the weak link

The Middle East shock has impacted EUR/USD in waves – first, the initial reaction that Europe is more exposed than the US, then a recovery on the view that the ECB would take forceful action by tightening policy, providing some support to EUR/USD. And it now looks like we are entering a new bearish phase for EUR/USD. This week's European PMIs have been poor and warn of weaker activity through the second quarter. Softer activity also brings into question how hawkish the ECB can be. In late April, the market was pricing close to 85bp of ECB tightening this year. That has now dropped to 65bp, with an ING house view that the ECB will hike just once in June.

The re-pricing of both the Fed and the ECB policy cycles has seen the two-year EUR:USD real yield differential move 30bp against EUR/USD over the last two weeks, and we expect there is more to come. Under 1.1575, we think EUR/USD can press 1.1500 again and, equally, any progress on peace discussions in the Middle East could see any corrective rally stall near 1.1660/90 on the view that the fallout from the energy shock will still be with us for the next couple of months.

For today, the focus is on the German Ifo at 10:00am CET. The expectations component should hold steady near 83.3/83.5 (its lowest since 2023), with any big miss potentially weighing on EUR/USD further. And again, Waller's speech will be important later in the day; look out for a speech from ECB President Christine Lagarde at 10:30am CET today, too.

Chris Turner

CHF: EUR/CHF hostage to the ECB

It seems clear that the Swiss National Bank is not going to do anything with monetary policy anytime soon. Earlier in the year, the debate was whether it needed to take its policy rate – now at 0% – into negative territory. With the oil price spike, that flipped expectations towards SNB tightening and indeed 20bp of tightening is priced in by year-end. We cannot see the SNB tightening this year at a time when it says it wants to intervene more intensively against the strong Swiss franc.

With SNB policy going nowhere, EUR/CHF is therefore being dragged around by the ECB tightening story. If the next chapter sees softer eurozone activity data raising questions over how much the ECB really needs to tighten after all, then EUR/CHF risks are skewed lower. Under 0.9125/35, EUR/CHF can drift under 0.9100. But 0.90 remains the line in the sand for the SNB. It's worth remembering as well that Switzerland has some of the least fossil fuel-intensive industries in Europe, suggesting the economy may perform better relative to European peers this year.

Chris Turner

TRY: Political uncertainty tests carry positioning

A Turkish court removed the leader of the country's main opposition party in a landmark ruling that triggered market volatility across assets. The Ankara appeals court annulled the results of the 2023 congress of the Republican People's Party, known by its Turkish initials CHP. The court decision cancels the election of Ozgur Ozel as CHP chairman. The market, remembering the turmoil of March 2025, went into defensive mode, and we saw a rapid sell-off in stocks and pressure on the lira.

The headlines came just before the local market close, so we will see the full reaction of rates and bonds only today. However, the FX market clearly showed which direction it was heading. Spot USD/TRY remains unchanged, but forwards came under expected pressure, and we saw a spike in 1m TRY implied yields from around 35% to 50%. The market closed lower at around 42%, still at significantly elevated levels, and we can probably see more of that today.

The media has suggested that USD6bn was spent by the Central Bank of Turkey to defend the TRY yesterday, which seems to us to be a reasonable number. This does not indicate a major problem for the central bank, and we do not expect a prolonged period of volatility; the market should stabilise by Monday, in our view. The latest central bank figures show $169bn in FX reserves, which puts the CBT in a strong position. For comparison, in March 2025, CBT lost around $33bn and around $18bn at the start of the US-Iran conflict. Still, TRY has just started to see a renewal of carry positions to around $52bn in our estimates, and we will see later in the data how much it has lost after yesterday. Depending on that data, we will also see whether the market will be more hesitant to increase exposure again.

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