

FX Daily: Markets steady ahead of final push on the debt deal

After a long weekend in many parts of the world, FX markets are returning to mull progress on a US debt ceiling deal. This now has to pass the committee stage in the House and will probably go to a House vote tomorrow. Progress on the deal will allow investors to focus on sticky US inflation – likely seeing the dollar hold onto recent gains



Joe Biden and Kevin McCarthy have reached an agreement to lift the US debt ceiling

USD: Progress on debt deal allows markets to focus on another Fed hike

After long weekends in many parts of the world, FX markets are returning to some progress on the US debt ceiling. President Joe Biden and House Speaker Kevin McCarthy have reached a two-year deal. That deal will be assessed by the House Rules Committee today and, if approved, will likely go to a vote in the House tomorrow. Both Democrat and Republican leaders feel they have the votes to get the deal through Congress – although at times like these, there may be a few holdout politicians who like their day in the sun.

Progress on the debt deal has seen some declines in yields for US Treasury Bills maturing in June,

although it has had little impact on FX markets. We said last week that FX markets had already been trading in a de-stressed fashion on the assumption a deal would go through. Assuming there are no hiccups in the deal's passage, FX markets can return to the most pressing issue of sticky inflation and what central bankers plan to do about it.

Last Friday's [US data set](#) made the firm case for one additional 25bp Fed hike – now fully priced by the time of the 26 July meeting. Money markets price a 63% chance of that hike coming earlier at the 14 June meeting – a meeting which will likely see the Fed have to raise its inflation forecasts. The default view, therefore, seems to be that the dollar can hold its recent gains at least into that June meeting. That is unless US price and activity data start to fall away sharply.

On that front, this week sees US JOLTS job opening data (Wed), ADP (Thurs.), and the May NFP (Friday). Barring any major downside miss in these releases, it looks like the market will support another 25bp hike from the Fed, continued inversion in the US yield curve, and a strong/stronger dollar.

DXY looks comfortable above 104.00 and could extend recent gains to 104.65 or even 105.30 this week.

Chris Turner

➔ EUR: Can China come to the euro's rescue?

EUR/USD has quietly slipped below support at 1.0700/1.0720 and may be gently making its way to the March lows at 1.0515/0530. As we mentioned last week, we think EUR/USD is relatively cheap given the massive reversal in energy prices over the last year and that, in time, the 1.05/1.07 area will come to be seen as a summer base. Helping that proposition would be some kind of recovery in China. The release of the China Beige Book has shown some recovery in the China manufacturing sector in May. Official May Chinese PMI figures are released later this week. A bounceback here, helping to reverse the recent run-up in USD/CNH, could provide the euro with some support.

For today, the eurozone focus will be on the release of industrial and consumer confidence figures for May. Consensus expects some further deterioration here and if so this should keep EUR/USD on the soft side. We will also hear from a raft of ECB speakers today. Expect more hawkish rhetoric especially in advance of the May eurozone CPI data on Thursday. Consensus expects core eurozone CPI to edge lower to 5.5% year-on-year in May. Another upside surprise here – feeding the sticky inflation narrative – warns that investors could return to pricing a 4.00% ECB deposit rate.

Chris Turner

➔ GBP: Hard to fight the aggressive BoE pricing

Money markets now price 100bp of Bank of England tightening by November. This would put the Bank Rate at 5.50%. Our team's view is that such an amount of tightening is highly unlikely and that the usually reticent Bank of England may try and verbally push back against it. However, UK data is doing the most of the talking and it will probably be the jobs/wages data (13 June) or the May CPI data (21 June) which will be the key determinant on whether the market reins in aggressive tightening expectations.

Until then, EUR/GBP can probably press support at 0.8650, below which 0.8600/8610 is the next target. GBP/USD can better resist the stronger dollar. Support around the 1.2275/2300 area may hold temporarily.

Chris Turner

➔ CEE: US dollar remains the region's nightmare

The second print of first quarter GDP in the Czech Republic will be published today. Besides the GDP breakdown, we will also see the wage bill, which has been mentioned several times by the Czech National Bank as a potential reason for a rate hike in June. Tomorrow, inflation for May and the details of first quarter GDP in Poland will be published. We expect headline inflation to fall from 14.7% to 13.0% YoY, below market expectations, mainly due to fuel and energy prices. On Thursday, we will see PMI numbers across the region, where we expect a slight deterioration in sentiment across the board. Later, we will see state budget data in the Czech Republic, which posted its worst-ever result in April, raising questions about additional government bond issuance. The European Parliament is also scheduled to hold a session on Thursday, which is expected to cover the Hungarian EU presidency and is also likely to touch on the topic of EU money and the rule of law.

The FX market, as usual in recent weeks, will be dominated by the global story and the US dollar. So, even this week, CEE FX will not be in a bed of roses. We still see the Polish zloty as the most vulnerable, which despite some weakening in the past week remains near record highs. The market has built up a significant long position in PLN over the past two months. Plus, we may hear more election noise. Moreover, the significant fall in inflation should push the interest rate differential lower. Thus, we see EUR/PLN around 4.540.

The Czech koruna remains the most sensitive currency in the region against the US dollar, which should be the main driver this week. On the other hand, the reversal in the rate differential has been indicating a reversal in EUR/CZK for a few days now. Thus, at least a stable EUR/USD could allow the koruna to move toward 23.600. The Hungarian forint can expect a headline attack from the European Parliament this week, and given the current strong levels, we could easily see weaker levels again closer to 375 EUR/HUF. However, we believe the market will use any spike to build long positions in HUF again.

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