

FX Daily: Oil dominates FX, Fed impact secondary

Markets are now speculating on a US military intervention in Iran, and oil prices are jumping again. This has triggered a renewed safe-haven appeal for the dollar, although this appears dependent on the ongoing extraordinary circumstances. Today, the Fed can give the USD some additional support, but it will still play a secondary role to geopolitics



Geopolitics has returned a temporary safe-haven appeal to the dollar

USD: Oil to outshine FOMC

The combination of rising geopolitical risk and oil prices has temporarily re-established some safe-haven appeal for the dollar. Yesterday's USD jump was likely exacerbated by some positioning squeeze, and triggered by another leg higher in oil prices as Israel intensified its strikes on Tehran, and speculation about the US joining the attack flared up. Should such speculation prove correct, the upside risks for oil could increase further, opening up fresh upside room for the dollar.

The extent of FX spillover from the Middle East conflict remains highly connected to the oil price impact. While it's hard to fight the current risk premium on crude, higher prices will need to be backed by evidence of supply disruption. The lack of that would mean that any dollar rebound

may prove as temporary as the oil spike. This also adds a new layer of uncertainty for FX, as volatile geopolitically-driven commodity swings are having a greater impact than macro news. The limited impact of yesterday's soft US retail sales is a case in point.

Domestically, all eyes will be on the Fed today. The FOMC will almost certainly keep rates on hold, and the focus will primarily be on the new dot plot projections. We expect them unchanged at 50bp of easing for year-end, but risks are heavily skewed towards a hawkish revision to just 25bp. We think the latest spike in oil prices may be offsetting recent positive news on inflation, especially as the Fed remains concerned about tariff-led price increases over the coming months. The overall message today should be broadly hawkish in our view, with continued caution on easing plans. That can help the dollar find support even if the bullish push from Middle East events starts to falter.

Another important macro development today is the release of TIC data for April. Our rates team previews the release [here](#). We expect that the adjustment in foreign Treasury holdings might not have been too dramatic in April, and at least a couple of months' data after 'Liberation Day' are likely needed to assess the extent of the rotation away from US assets.

Francesco Pesole

📉 EUR: Buying the dips remains a clear risk

Geopolitical events are causing a temporary dislocation from macro-driven price action in EUR/USD. Even before very soft US retail sales were published, the German ZEW had come in quite strong, with the "expectations" index essentially back at pre-'Liberation Day' levels. Although the overbought and overvalued condition of EUR/USD suggests further corrections, the preference to buy on dips due to structural bearish views on the USD may only be put on pause until oil prices absorb the geopolitical shock.

So while the dollar may indeed regain some near-term momentum, we don't think this will be enough to take EUR/USD sustainably back to the 1.12-1.13 area. Our near-term target remains 1.14 for the pair.

Today, the eurozone data calendar is light, but there are plenty of ECB speakers. Given the sensitivity of the ECB's inflation projections to oil price swings, we can probably expect even more cautiousness by the Governing Council in light of recent events. Markets will probably feel little pressure to price back a rate cut earlier than December for now.

Elsewhere in Europe, Sweden's Riksbank is expected to cut rates by 25bp, in what in our view will be the last move of the cycle. While the recent oil price spike means a slightly greater chance of hold, we doubt the Riksbank will want to surprise a market that is pricing in 22bp. The risks are, however, skewed to the hawkish side when it comes to forward-looking language, which can offset the rate cut impact on SEK. The krona's limited reaction to geopolitical risk reinforces its new role as a stable currency, and we still expect gradual EUR/SEK depreciation in the coming months.

Francesco Pesole

📉 GBP: Inflation adds to dovish BoE arguments

The UK has just released CPI figures for May. While the headline reading slowed a tad less than expected to 3.4%, and core was in line with consensus at 3.5%, the closely-monitored services CPI

came in a bit below expectations at 4.7% (expected 4.8%).

The Bank of England's recent hawkish turn has not been endorsed by data so far, as jobs, growth and now inflation figures have come in on the soft side. But it raises the risk of a slightly more dovish tone tomorrow; although not of a cut, which remains rather unlikely. Here is our full [BoE meeting preview](#).

For now, there aren't many arguments against EUR/GBP strength. Geopolitical risks generally harm the pound more than the euro, and the data flow has been GBP-negative of late. Unless the BoE surprises with a more hawkish-than-expected message tomorrow, a move to 0.860 may well be on the cards.

Francesco Pesole

CEE: More hawkishness from the CNB and fiscal package in Romania

Today's calendar in the region is empty, and the market should focus on bond auctions in Poland and the Czech Republic. However, there are a few stories in the background that we will be watching. As we have highlighted in previous days, today marks the start of the Czech National Bank (CNB) blackout period ahead of next week's meeting. The central bank has been surprisingly quiet, with no new updates in recent days aside from last week's interviews. Therefore, we believe today is the last chance, and we should see some hawkish headlines. Also in the Czech Republic, the government faces a no-confidence vote, but that should be a non-event based on the head count of the ruling coalition.

In Romania, the media is reporting some progress in negotiations on the government and fiscal package that should be unveiled this week. Media rumours suggest a broad coalition and a medium-sized fiscal package that should push this year's deficit below 8% of GDP. The market reacted yesterday with a rally in Romanian government bonds, but confirmation will likely come on Friday. EUR/RON is also gradually grinding lower with yesterday's rebound from 5.02 looking like a limit.

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