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FX Daily: Subdued oil volatility preventing USD breakout

Upside volatility in oil prices has remained surprisingly limited, considering the lack of tangible progress in US-Iran negotiations. That is preventing the dollar from breaking higher despite the strong macro backdrop. Still, we expect another solid US jobs report today, underpinning the firm USD momentum

Another solid US jobs report today should further support the US dollar's current momentum

USD: Payrolls should remain USD supportive

Brent's inability to trade back to $100/bbl remains a bit baffling. The longer the supply disruption lasts, the more vulnerable the oil market should be and, in theory, face greater upward volatility whenever de-escalation hopes aren't fulfilled. Our commodities team also notes that total inventory draw over the last month and a half has been 32m barrels, and even if the Strait of Hormuz flows resume today, inventories are likely to continue to tighten into the third quarter, leaving upside risk to prices.

To keep oil prices at these levels, there must therefore be a big deal of optimism about a peace deal baked in. This is preventing the USD from breaking higher in an environment that is otherwise materially stronger than a month ago for the greenback thanks to hawkish Fed repricing.

Today's US May jobs report will test rate expectations. We look for payrolls slightly above consensus (100k vs 88k) and unchanged unemployment at 4.3%. Markets are awaiting the catalyst to leap into fully pricing in a rate hike by the Fed this year (now 17bp) – an upside surprise today could be that. A near-consensus print would probably only cement recent hawkish moves and create a firmer floor for the dollar whilst awaiting news from the Gulf.

Francesco Pesole

EUR: Risks remain on the downside

EUR/USD bounced around yesterday, but remains stuck in a 1.160-1.1650 range that has held for most of the past two weeks. It's still quite telling that the pair is trading about 1.5% lower than when oil was at these levels in April.

The partial disconnect with oil prices remains a clear testament to the short-term rate differential returning as a more prominent driver for EUR/USD, something that is confirmed by the beta in our short-term fair value model.

We continue to view next Thursday's European Central Bank meeting as a moderately positive euro catalyst, with a hawkish 25bp hike expected. Until then, risks remain skewed towards a break below 1.160, absent tangible progress in US-Iran negotiations.

Francesco Pesole

CAD: Hoping for some stabilisation in jobs

Canada releases May's job market data at the same time as the US today. The narrative here has been less constructive. April figures were poor, with unemployment jumping to 6.9% and 17.7k net job losses.

Consensus is looking at a stabilisation today: 6.9% and +10k. But unless we see unemployment inch back lower, the contribution of the jobs market to the Bank of Canada policy will remain dovish.

The USD/CAD two-year swap rate gap has widened by around 25bp to its highest level since pre-liberation day. That has underpinned the recent rally in USD/CAD, alongside the first signs of risk premium emerging about the USMCA renegotiations.

Our view remains more dovish than the market on the BoC, which still appears to have a higher bar for hiking rates than the Fed due to domestic economic challenges and uncertainty about the USMCA.

So, while our call beyond the short-term still leans USD bearish, we remain less excited about the potential of the loonie relative to other commodity currencies (the Australian dollar, New Zealand dollar, and Norwegian krone). In the coming days, the risks of a test of 1.40 in

USD/CAD are non-negligible.

Francesco Pesole

CEE: June CNB meeting set to be lively amid rate hike potential

The end of the week in CEE will see some interesting numbers, with attention shifting to Turkey's May CPI data. The market expects stagnation at around 32.50% year-on-year with a visible slowdown to 1.6% month-on-month from 4.2%. This would mean some relief from the accelerating momentum since the beginning of the year. Still, the Central Bank of Turkey is not in a position to win here, with significant current account exposure to the US-Iran conflict and an unclear inflation path for the rest of the year.

Meanwhile, in Hungary, industrial production figures for May will be published today after retail sales figures showed a decline yesterday. In the Czech Republic, retail sales should show consumer sentiment after yesterday's wage figures surprised to the upside.

Yesterday's inflation in the Czech Republic surprised to the downside with a drop from 2.5% to 2.1% YoY, which caught the market on the hawkish side after the Czech National Bank's comments about a possible rate hike at the June meeting. Although we saw a quick rally after the morning numbers, by the end of the day we still ended with almost an entire rate hike priced in. Wage numbers surprised to the upside, providing a further hawkish note to the story.

The June meeting will be lively, but the outcome is unclear for now. Our economists' baseline expectation is no change, but our side of the probabilities is more towards a rate hike. EUR/CZK stabilised around 24.200 and, after some long months, it has come out of the usual ranges. We could hear more from the CNB next week, which should help to decipher its direction moving forward.

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