FX Daily: Three hot weeks ahead

Heatwaves will also be felt in markets in the next three weeks. The politics-policy dichotomy peaks with French elections (30 June, 7 July) and key US data, including May core PCE on Friday, which is expected at 0.1% MoM. That should endorse our September Fed cut call, but the French vote means EUR/USD can still build (negative) risk premium in the near term

25bp-50bp rates cuts in Europe and Canada can keep the dollar bid this week

USD: PCE vs French elections

There are five big dates in markets over the next three weeks. On Sunday 30 June, there is the first round of the French parliamentary election – although certainty on how far Marine Le Pen's party has advanced will only be clear after the 7 July round of constituency run-offs. In the US, May PCE figures are released this Friday, and will be followed by June jobs report on 5 July and June's CPI on 11 June.

As discussed in our latest FX Talking monthly update, both politics and monetary policy will need to be pondered in the first part of the summer. The dollar has emerged as the favourite hedge for political uncertainty, especially as gains in the EU's natural safe-haven – the Swiss franc – are being actively thwarted by the Swiss National Bank.

If the US May core PCE on Friday does come in at the consensus 0.1% month-on-month, the short-term downside for the dollar against European currencies may be less pronounced as markets could still favour defensive positions ahead of the French vote on Sunday. When taking EU political noise out of the equation, though, PCE data should in our view feed into an increasingly dovish Federal Reserve narrative this summer, culminating with a September rate cut. This is why we remain generally bearish on the dollar for the end of next quarter.

Already this week, the likes of AUD/USD, NZD/USD and USD/JPY could be a preferred channel of some PCE-induced USD weakness. The yen seems to be desperately needing another supportive input from US data, as investors are looking right through the threat from Japanese authorities to intervene 24 hours a day and USD/JPY is back at 160. The Bank of Japan also released policy minutes this morning and seemed to open the door to a July hike, an option that will gather more traction (6bp priced in now) if FX interventions continue to prove ineffective in taking the yen back higher.

Another event to watch this week is the Iranian presidential election on Friday, although reports suggest a run-off (5 July) is likely, with three candidates seen as major contenders: one reformist and two conservatives.

Today, the only US data release is the Dallas Fed manufacturing index, while three Fed speakers will deliver remarks: Christopher Waller, Austan Goolsbee and Mary Daly. We think DXY can trade above 106.0 and potentially test the 106.50 May high into the events at the back-end of this week.

Francesco Pesole

EUR: More space for risk premium build-up

Latest polls show Marine Le Pen's far-right RN party remains in the lead (35%) ahead of Sunday's first round parliamentary vote, followed by left-wing NPF party (29%) and President Emmanuel Macron's centrist coalition (19%). Barring a change in these poll figures before the weekend, political uncertainty may well keep a lid on the euro in the coming days.

We continue to keep a close eye on the EUR/USD risk premium (i.e., undervaluation in our short-term fair value model). As of Friday's close, that amounted to 0.9% in our estimates, well below the 2.4% 14 June peak and also below the 1.8% we had identified as historical benchmark in this note. We saw the 10-year OAT-Bund spread widen to a new peak (82bp) on Friday, and the there are lingering risks of further pressure on French bonds into the vote. We see risks skewed to the downside for EUR/USD before the Friday-Sunday events in the US and the EU.

Today, the German IFO survey will add information on how much political uncertainty has spread to German business confidence following soft PMIs last week. On Friday, CPI figures for France, Spain and Italy will start directing expectations ahead of the eurozone-wide estimate for June released on 2 July, but the proximity to the French vote means any upside surprises may still struggle to feed into a stronger EUR.

EUR/USD may find more sellers below 1.0700 in the coming days on the back of political risk. Should US PCE offer no support to the pair, the 1.0600 April lows will be at reach. Another pair to watch this week is EUR/SEK, which has paused its big downward trend ahead of the Riksbank announcement on Thursday. We expect a hold with unchanged guidance, and limited implications for SEK. Catch our full preview here.

Francesco Pesole

GBP: EUR/GBP bulls need patience

We believe the Bank of England took a step in the direction of an August rate cut last week, even though core policy communication did not change meaningfully. Markets remain undecided on an August move (14bp priced in) and in our view, are also still too conservative on the total easing this year with 47bp versus our call for 75bp.

Our dovish BoE view means a bearish call on the pound this summer. We could also see some negative spillover on GBP from the UK election (4 July), where a Labour landslide win is largely expected – but perhaps a good result from the populist hard-Brexiteer Reform UK party may create some market jitters.

However, political uncertainty currently weighs more on the euro than on the pound, and that's why we think a re-appreciation in EUR/GBP beyond 0.8500 has likely been delayed. Still, we see wide upside room for the pair once the EU political noise has settled due to monetary policy convergence. The pound looks more likely to display weakness against the dollar in the near term, and we expect a move to below 1.25 in Cable in July. This week's calendar is very quiet in the UK data-wise, and there are no BoE speakers scheduled for now.

Francesco Pesole

CEE: The Czech Republic and Turkey to discuss rate decision this week

A busy week in the CEE region starts today with consumer confidence in the Czech Republic and retail sales in Poland. Markets will be looking for confirmation of a recovery in consumption in the region. Tuesday and Wednesday will see the release of labour market data in Poland and current account data in Hungary. However, the second half of the week will be more interesting. Thursday will see central bank decisions in the Czech Republic and Turkey. We expect the Czech National Bank to cut rates by 25bp to 5.00%, in line with surveys, but communication from the board indicates that 50bp will also be discussed. The Central Bank of Turkey will leave rates unchanged at 50% and maintain its tightening bias. Poland will release inflation for June on Friday – as always, the first number in the region. We expect an unchanged number at 2.5% year-on-year, slightly below market expectations. In the Czech Republic, the final first quarter GDP numbers will be released, which could tell us more about the record drop in investment.

A stronger US dollar last week blocked the CEE region's potential, but we remain bullish here. Both a higher DXY and a small correction in European equity markets are creating a slightly negative environment. On the other hand, rate differentials across the board should still push the CEE to some gains this week. We therefore remain positive on PLN and HUF, but less so than last week, with the preference shifting from PLN to HUF. We see EUR/PLN closer to 4.310 and EUR/HUF closer to 394.

EUR/CZK is mainly driven by the rate cut discussion of 25 or 50bp this week. The pair, under pricing pressure moving towards a larger rate cut, approached 25.00 on Friday and we are likely to stay at these levels into the meeting. While the market has priced in a near 50bp rate cut, we think the CNB decision will have a symmetrical impact on the CZK. However, in both scenarios, we think we will see the weakest levels of the CZK on the day of the meeting and the next weeks should bring appreciation given that already the central bank will turn hawkish in any case and macro fundamentals are strenghtening.

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