FX Daily: Time for the dollar to pause?

Equities and yields are rebounding on the back of gradually improving optimism on US debt-limit negotiations. However, the dollar remains bid and pro-cyclical currencies under pressure. We could see a pause in the dollar appreciation today as EUR/USD approaches the 1.0800 support and jobless claims might deliver another bad surprise to the greenback

USD: FX stays more pessimistic on debt ceiling

The narrative around US debt-limit negotiations has continued to gradually improve. President Biden has remained optimistic about reaching a deal, but markets are primarily following House Speaker Kevin McCarthy's comments on the issue. He has changed his own rhetoric from stressing the two sides remained far apart to saying that achieving a deal is doable. Currently, staff-level talks are being held while President Biden is attending the G7 summit in Japan.

We are seeing diverging reactions in asset classes: US equities rebounded, treasuries remained under pressure, but the dollar – which should underperform in a risk-on repricing – continued to appreciate. We are witnessing an unusual combination of the most high-beta currencies like Norway's krone falling in line with the safe-haven Japanese yen. The yen's weakness primarily mirrors the recent US Treasury's underperformance while the dollar's strength, paired with pressure on commodity currencies, signals how the FX markets seem to be lagging the cautious optimism shown in other asset classes like equities.

At the same time, with EUR/USD close to the pivotal 1.0800 support level and the news coming from Washington admittedly more encouraging, we could see a stabilisation, or a small correction in the dollar, rather than further appreciation today. Data will also be in focus in the US with jobless claims, which surprised on the upside recently, expected to decline from 264k to 252k, possibly carrying some downside risk to the greenback. Home sales data from April and the Philadelphia Fed Business Outlook will also be published, while the Fedspeak calendar includes Philip Jefferson, Michael Barr and Lorie Logan.

Francesco Pesole

EUR: Chances of a break lower have declined

Recently, we have been stressing the relevance of 1.0800 – in our view – as the benchmark level in EUR/USD to gauge market sentiment about the US debt-limit story. As briefly discussed in the USD section above, the improvement in the rhetoric by Biden and McCarthy and the positive reaction in US equity markets suggests we could see a stabilisation in EUR/USD today. The chances of 1.0800 being tested remain tangible, but those of a decisive break lower have likely declined.

Markets will keep drawing very little information on the domestic side from the eurozone, with the data calendar being rather empty – only the European Central Bank economic bulletin today – and two ECB speakers (Luis de Guindos and Madis Muller) which may not drive any real market impact.

Francesco Pesole

GBP: Another speech by Bailey today

Some comments from Bank of England Governor Andrew Bailey yesterday did not add much to the recent BoE rhetoric. Expectations are for a rapid decline in inflation, but policymakers remain ready to react to signs of persistence in price pressures and will be closely monitoring wages, services and labour tightness.

We recently discussed how UK wage data marginally pointed towards a pause at the June meeting, in our view. Given the Sonia curve currently prices in around 19bp of tightening for June and 40bp in total before the peak, we think there is plenty of dovish repricing to be passed through to sterling, and we expect EUR/GBP to climb from these levels: we target 0.88-0.89 this summer.

Today, the UK data calendar is empty, but we'll hear from BoE Governor Bailey again as he testifies – along with Ben Broadbent and Dave Ramsden – to the Treasury Select Committee about quantitative tightening. This morning, there is also a scheduled speech by Chief Economist Huw Pill.

Francesco Pesole

AUD & NZD: Flipping narrative

First-quarter wage data offered - in our view - enough motive for the Reserve Bank of Australia to keep tightening policy despite not coming in at screamingly elevated levels, but today's employment figures in Australia may complicate any plans to hike again. Employment dropped 4k in April (expected +25k), which led the unemployment rate to rise from 3.5% to 3.7%. The details of the report are rather grim too: the drop was all due to full-time employment (-27k), while part-time hiring actually accelerated (+23k).

The release probably flips the narrative for AUD/NZD: from a potentially bullish opportunity to a growing chance that the recent 1.0600 recent lows (and important support) will be heavily tested. Still, we must remember there is close to nothing priced in terms of RBA tightening, so the room for a dovish re-pricing to hit AUD is limited.

On the NZD side, the Treasury announced its budget today, which came with a larger deficit, with a focus on reconstruction spending after the recent severe weather events. Somewhat surprisingly, the Treasury now sees the extra spending, combined with the tourism boost, as allowing New Zealand to dodge a recession – which is instead the Reserve Bank of New Zealand's baseline scenario, according to February's projections. An improved economic outlook, and expansionary fiscal policy – paired with a surge in migration - also means price pressures may last longer, and puts pressure on the RBNZ to stay hawkish next week. A 25bp hike is our (and consensus) call, but the focus will mostly be on the new rate projections: more tightening may now be pencilled in after the budget, and this could lead to NZD outperforming AUD.

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