

FX Daily: Trading the 50-50 risk

Despite the very strong headline US May payroll figure, rising unemployment and declining wage inflation are keeping markets from fully pricing in a June Fed hike (we expect a hold). Barring a big ISM services surprise today, the lack of other key inputs before next week's CPI could keep the dollar capped. The RBA decision tomorrow is also a 50-50 decision



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➔ USD: Not enough to price in a June hike

The blowout May headline payroll number added fuel to the narrative of an extra tight US labour market, but the coincidental rebound in unemployment to 3.7% and slowdown in wage growth kept markets from going all-in on a June rate hike by the Federal Reserve. As [discussed in this note](#) by our US economist, payrolls and the unemployment rate are calculated through different surveys: the former by employers, and the latter by households. In practice, firms and households conveyed very different messages about the direction of the US labour market in May.

We think that, when adding the cooling off in wage inflation, and considering the diverging views within the FOMC, the case for a pause at the 14 June meeting should prevail. The last big risk event before the rate announcement is the 13 June CPI reading, while today's ISM services figures (the

consensus expects a mild improvement) might have a somewhat contained impact on rate expectations, barring major diversions from expectations. The FOMC has already entered the black-out period.

Markets are currently pricing in a 25-30% implied probability of a hike in June, while 21bp are factored in by the end-July meeting. We suspect that the pricing may not vary considerably, or that the narrative of a “50-50” chance of a hike in June may prevail until the CPI numbers next Tuesday – and barring a surprise there – into the FOMC announcement itself.

With markets not having received enough compelling evidence from the May jobs report to price in more than a 50% probability of a June hike, we feel that two-year USD swap rates, which rebounded to 4.73% after having declined to 4.51% on Friday, may struggle to find much more support this week.

Add in a period of potential market sentiment stabilisation now that the debt-ceiling saga has ended and we think the dollar's bullish momentum may dwindle into the FOMC meeting. We see a higher chance of DXY stabilising around 104.00 or pulling back to 103.00. Some pro-cyclical currencies could emerge as outperformers in this period: the Canadian dollar, for example, may stay supported now that Saudi Arabia announced another one million barrels a day of oil production cuts and [even if the Bank of Canada stays on hold](#) on Wednesday, as long as it keeps the door open for a potential hike down the road.

Francesco Pesole

➔ EUR: Lagarde's rhetoric facing a test

The main highlight of the day in the eurozone is the testimony by European Central Bank President Christine Lagarde before the Committee on Economic and Monetary Affairs of the European Parliament. The quite consistent hawkish rhetoric we have heard from Lagarde and the majority of ECB speakers since the latest ECB meeting will now need to face the evidence that eurozone inflation is declining more rapidly than expected.

It does not seem highly likely that Lagarde will signal a U-turn in her communication only 10 days before the ECB meeting, and markets are still pricing in two more hikes before the peak, meaning that the bar for a dovish surprise is still set quite low. Later in the day, the hawkish message should be reinforced by a speech from Bundesbank Governor Joachim Nagel.

Our point in the USD section about a potential halt in the rebound in USD short-term swap rates means that the two-year EUR-USD swap rate gap may also find some respite after having collapsed from -62bp to -116bp in the past four weeks. We feel that EUR/USD could find some support around 1.0650/1.0700 and even stage a rebound back to 1.0800/1.0850 this week.

Francesco Pesole

⬆ AUD: RBA hike is a 50-50 affair

The Reserve Bank of Australia has had a tendency to surprise markets in recent months. As it prepares to announce monetary policy tomorrow, markets (40% implied probability of a hike) and consensus are split between a 25bp rate increase and a hold after a set of contrasting data in Australia. We agree that the chances of a hike are very close to 50-50: 1Q wage data pointed to [more tightening in our view](#), but April jobs figures were dismal. When April CPI data was released

last week and surprised with a jump to 6.8% year-on-year, and Governor Philip Lowe sounded open to all options by reiterating data-dependency, the probability of a June hike jumped again.

In theory, data dependency means that the prospect of a “hawkish hold” or “dovish hike” should not be on the spectrum of possibilities, and even though the shades of central bank communication can admittedly be quite varied and creative (Lowe will speak Wednesday morning), we see tomorrow's risk event as quite binary for the Australian dollar. A hike could see AUD/USD initiate a move that can take it to stabilise around 0.6700 towards the end of this week; a hold raises the risk of sub-0.6500 lows being tested again soon, even though we think less USD strength can favour stabilisation in the pair regardless of a hawkish surprise by the RBA.

Francesco Pesole

CEE: Dovish tone to put pressure on FX

The Czech Republic's 1Q wage data will be published today, which is perhaps a more important number for the central bank these days than inflation itself. The Czech National Bank expects 9.1% YoY, monthly data and national accounts point to a higher number, but it should remain below 10%, the pain threshold mentioned by the board. Tomorrow, we will see industrial data in the Czech Republic and retail data in Hungary. Later, the decision by the [National Bank of Poland](#) will be announced. In line with the market, we expect rates to remain unchanged. The main focus will be the governor's press conference, which we expect to be dovish in tone, supported by a fall in inflation. Hungary's industrial production will be released on Wednesday, and we expect a 6.5% YoY decline, well below market expectations. Then on Thursday, we will see May inflation in Hungary, which is expected to fall further from 24.0% to 22.1% YoY, slightly below market expectations. Hungary's state budget result and Romania's second estimate of 1Q GDP will also be released.

In the FX market, we will be watching the echoes of Friday's US labour numbers, which bring positive sentiment, but also higher dollar rates. However, a stronger dollar will still keep pressure on CEE FX and we remain bearish. Moreover, local numbers across the region should favour a dovish tone this week, pushing interest rate differentials lower. After rallying in recent days, we think the Polish zloty and Hungarian forint are most at risk. The market has built large long positions in both currencies and the dovish tone this week should lead to some market rebalancing. Thus, we should see a return closer to 4,520 EUR/PLN and 372 EUR/HUF.

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