FX Daily: Trump's tax bill is anything but "beautiful" for the dollar

House Republicans may have reached some agreement on Trump's flagship "Big, Beautiful Bill", which has caused market concern over the deficit and raised downside risks for the dollar. There are tentative signs of stabilisation in Treasuries and US stock futures this morning, and the USD can find some support, but a sustained recovery looks unlikely

House Speaker Mike Johnson said a vote on Trump's tax bill will take place on Thursday

USD: Trading US deficit fears

Yesterday, we suggested that the G7 finance ministers' meeting in Canada could produce USD-supportive headlines, particularly if there were signs of easing trade tensions. So far, the summit has been quiet, but with meetings concluding today, we could still see market-moving headlines.

Instead, market attention has largely shifted to developments surrounding the US tax bill. House leaders are pushing for a vote before the Memorial Day recess and have introduced a revised version that raises the threshold for tax deductions– an expansionary measure aimed to win over moderate Republicans – as well as faster Medicaid cuts backed by more conservative party members. Market concerns over the deficit impact of the bill have intensified this week, and triggered another coordinated selloff in US equities and bonds yesterday. The dollar is falling across the board as a consequence. A softish 20-year auction yesterday added further pressure on Treasuries, with the widening 10Y UST-SOFR spread to -58 indicating fresh market stress.

US equity futures and Treasuries are stabilising this morning, but the risks of another rough session for US markets remain tangible. Any relief from deficit-related concerns could be further reinforced by positive headlines on trade emerging from the G7 finance meetings in Canada.

The post-'Liberation Day' episode underscored how quickly the dollar can fall amid renewed confidence issues surrounding US assets, and downside risks for the greenback remain elevated. At the same time, it highlighted that pressure in Treasuries—more so than in equities—has the potential to prompt policy reassessment in Washington.

Early signs of a somewhat steadier market after the latest US tax bill developments suggest we could see the dollar find some tentative support or even rebound today. Still, markets may well favour selling into DXY strength above the 100.0 level. Today's data calendar features the S&P Global PMIs, which could add to pressure on the dollar if they fall below the 50.0 contraction threshold that has held since early 2023.

Francesco Pesole

EUR: PMIs in focus today

European currencies continue to gain ground, supported by a rotation out of US assets. Markets might also be partly factoring in last week's unexpected Reuters report that the European Central Bank has asked banks to stress test their USD funding needs amid concerns the Federal Reserve could restrict access to emergency USD swap lines. While this scenario appears somewhat unlikely, should the risk be deemed credible, it could prompt even faster diversification away from the dollar.

Today's focus will be on the PMIs, which tend to have a greater impact on European FX than on the dollar, and will be released alongside the German Ifo index. Both the eurozone PMIs and the Ifo are expected to show only marginal improvement, likely insufficient to challenge the market's firm expectation of around 50bp in ECB rate cuts by year-end.

We generally deem a move to 1.150 in EUR/USD as premature given the lack of hard evidence on the economic damage in the US from tariffs. To be sure, if PMIs reveal a growing divergence between the US and Europe, the G7 summit fails to offer signs of trade de-escalation, and above all, Treasury markets remain under pressure, another leg higher in EUR/USD would be inevitable.

Francesco Pesole

GBP: EUR/GBP drop delayed

As discussed in this note by our UK economist, April's rise in UK services inflation was mostly down to a temporary spike in air fares and package holidays caused by the timing of Easter—an effect that should unwind soon. Other key areas like restaurants, medical care, and rents are showing signs of disinflation. While rent is still propping up the overall figure, its impact is set to shrink next year. Our view is that services inflation will fall further this summer, and while levels remain high for the Bank of England, an August rate cut still looks on the cards.

Markets have scaled back easing bets only modestly, and an August move is still just about 50% priced in. As a consequence, there hasn't been much support for the pound coming from the CPI release, and EUR/GBP is likely finding support from market instability borrowed from the US.

We still like the chances of EUR/GBP below 0.840, although calmer asset markets are likely a necessary condition.

Francesco Pesole

CEE: Global story favours more gains for region

Yesterday's data in Poland surprised to the upside after several months of negative surprises. April data from industry and the labour market suggest an encouraging start to the second quarter in Poland. One data point does not make a trend but we see encouraging signs that the recovery has resumed. At the same time, there was a clear rebound in wage growth in April, but the downward trend should continue in the coming months, in our view. From the perspective of monetary policy, lower wage pressure than in 2024 is good news and creates room for further declines in core inflation. However, the rebound in wages compared to 1Q25 increases uncertainty about the extent of any further slowing in wage growth. Also, the April data shows that the economy continues to gradually recover. We expect the National Bank of Poland to further cut rates this year by another 75bp to 4.50% by the end of 2025, otherwise the real ex-ante rate would grow and tighten monetary policy.

Today in the CEE region, the calendar is again quieter and we have only industrial production in Romania and speakers in Hungary. We should hear from central bank and government officials at local conferences, which often trigger headlines. We believe the National Bank of Hungary wants to maintain a hawkish tone despite weaker economic data and a mixed picture on inflation and the impact of government measures. On the other hand, fiscal policy often generates some headlines.

CEE currencies have stabilised stronger in the EUR-crosses after a more volatile start to the week, and continue to rally against the USD and this should be the direction for the rest of the week. Short-term momentum favours the CEE region with talk of a Ukraine-Russia deal and higher EUR/USD.

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