FX Daily: Focus on US-China trade talks supports risk assets

Financial markets are leaning towards a glass-half-full view of the world right now. The MSCI world equity index is trading at all-time highs, and investors are scaling back expectations for the size of forthcoming monetary easing cycles. Trade talks in London today between the US and China should keep the risk environment calm and the dollar supported


US-China trade talks in London today should provide some support to the dollar

USD: Trade talks should be a dollar positive

Ever since US President Donald Trump's 'Liberation Day' tariffs were introduced in early April, the FX narrative has really focused on what damage these tariffs would do to the US economy and the dollar. News, then, of a meeting in London today between US and Chinese officials should in theory be good news for the dollar. Presumably, both sides would not be meeting if they felt they couldn't put a deal together. In focus here will be whether the deal made in Geneva last month can be made permanent, and that the threat of 100%+ tariffs does not return.

This all comes at a time when the MSCI world equity index is trading at all-time highs and investors seem to be taking a glass-half-full view of the world. This has seen traded FX volatility levels start to fall a little, even though we have some event risk on tariffs in early July. Lower volatility is also encouraging more interest in the carry trade, where Latam currencies and their 9-14% per annum implied yields are proving attractive.

The main threat to this environment might once again prove the US bond market this week. We have $119bn of Treasury issuance Tuesday-Thursday; $58bn 3-year, $39bn 10-year and $22bn 30-year. Any poor auctions or a surprisingly wide May monthly budget deficit (released Wednesday evening) could easily see fiscal risk insert a risk premium back into US asset markets.

When it comes to data this week, Wednesday's main event of the May CPI release may come in again at a benign 0.2% month-on-month on the core reading. There are no Federal Reserve speakers scheduled as we're now in the blackout period ahead of the 18 June FOMC meeting.

Given the Whit Monday holiday in Europe today, FX trading could be a little more subdued. However, with a speculative market already short dollars, DXY could drift towards the 99.40/50 area in anticipation of some good news out of US-China trade discussions.

Chris Turner

EUR: ECB's infectious optimism

The euro has remained reasonably well supported after Thursday's European Central Bank meeting. Here, President Christine Lagarde painted a picture of eurozone growth even in the face of global uncertainty. The market continues to price just one more ECB rate cut, but not until December this year. And we suspect more focus on German fiscal stimulus when a new budget is released later this month should keep the euro supported.

If you haven't seen it already, please take a look at this EUR/USD poll we took last Tuesday. We've been taking these polls roughly every quarter over the last three years, and typically, the results would show a normal distribution around the prevailing spot level. This poll result of 57% of respondents expecting EUR/USD to end the year in a 1.15-1.20 range is one of the highest conviction views we've seen so far. Our baseline view currently is one of an ongoing 1.10-1.15 range this year, where a later start to the next bout of Fed easing can provide the dollar a little support. Yet the risk to our baseline EUR/USD view is clearly to the upside.

On the eurozone calendar this week is the release of the eurozone wage tracker on Wednesday and a whole host of ECB speakers.

Expect EUR/USD to trade well within Friday's 1.1370-1.1455 range, given today's European holiday.

Chris Turner

GBP: Quiet appreciation

GBP/USD remains quietly well bid as it rides on the coat-tails of a stronger euro. As a major reserve currency, sterling in theory should benefit from any de-dollarisation flows. And with one-week deposit rates at 4.25%, sterling is also seen as an attractive dollar alternative during quiet market conditions, like now.

On the calendar this week for sterling is jobs data tomorrow and the UK government's spending review on Wednesday. Neither should be a game changer for sterling. Expect Cable to trade a

1.3500-1.3600 range, although there will be some downside risks at some point if we're right with our call for two 25bp Bank of England rate cuts this year. The market currently prices just 36bp of rate cuts this year.

Chris Turner

CEE: Inflation prints across the region

Central and Eastern Europe remains busy this week, with inflation numbers being released across the region. Tomorrow, the final May inflation number will be released in the Czech Republic. Last week's flash reading surprised on the upside with a rise from 1.8% to 2.4% year-on-year, with the details suggesting strong core inflation of around 2.8-2.9%. If confirmed, the Czech National Bank will face the risk of exceeding 3% in June, which could end the cutting cycle.

May inflation in Hungary will be released on Wednesday, where we expect the headline number to be unchanged at 4.2%, in line with the market. Core inflation is expected to fall from 5.0% to 4.7% YoY. Also on Wednesday, Poland will hold a vote of confidence in the government in response to the presidential election results and the victory of the opposition candidate. We expect the government to confirm the confidence vote in the parliament.

On Thursday, we will see May inflation in Romania, where we expect a rise from 4.9% to 5.4% YoY. And on Friday in Poland, we expect that May inflation will be confirmed at 4.1%, with the breakdown refining our core inflation calculation to 3.3%. Current account data in Poland and the Czech Republic will also be released.

The CEE currency picture remains bullish. Core markets pushing up CEE rates are leading to widening interest rate differentials. Moreover, a weaker dollar continues to support currencies in the region even after the US jobs data release on Friday. In the Czech Republic, higher core inflation and potentially some hawkish statements from the CNB should push EUR/CZK down below 24.750. Wednesday's government confidence vote should be positive for the Polish zloty, unlocking potential coming from a hawkish National Bank of Poland and higher rates. EUR/PLN is pointing to 4.250-260 levels based on rates, showing decent rally potential for PLN.

Frantisek Taborsky

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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