The US vs the rest of G7

No clear agreement at the G7 this weekend will likely weigh on risk assets on Monday, as the threat of a global trade war escalates

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USD: The US vs the rest of G7

The focus today turns to the start of the G7 summit in Canada. Divisions between the US and the rest of the G7 member states are growing in response to US tariffs, with French President Emmanuel Macron threatening not to sign the joint statement if there's no progress on this issue. If there is no clear agreement and differences widen further, this is likely to weigh on risk assets on Monday, as the threat of a global trade war escalates. In such an environment, the US dollar would do well against most G10 FX (bar the Japanese yen) and strengthen against emerging markets FX.

EUR: ECB QE tapering expectations build

With the June ECB meeting approaching (next Thursday) and expectations building (following the hawkish ECB signals), EUR/USD has been gaining ground again. As per our ECB Preview, our economists expect the ECB to extend quantitative easing by one more quarter to the end of 2018, with the central bank decreasing its monthly purchases from €30 billion to €10 billion. Today, the focus is on a speech by the ECB's Yves Mersch in Paris but that is likely to lag the market moving momentum of Peter Praet's speech on Tuesday. EUR/USD to stay below 1.1800 today following the softer than expected April German industrial production this morning.

HUF: Higher CPI in line with the upside surprise in the eurozone

Hungarian May CPI will likely accelerate to 2.6% on the back of an oil price shock, in line with Europe. In fact, there are upside risks to the May CPI stemming from the way the statistical office gathers gasoline prices. While in the case of the Czech koruna or Polish zloty, an upside surprise to local CPI would be positive for the respective currencies- as the market would price in the rising probability of tighter monetary policy- for the Hungarian forint, the effect is less clear given rising market concerns about the central bank's credibility, the sustainability of its very unorthodox policy stance and its potentially negative effect on the local bond market.

BRL: Under pressure

In response to the pressure on the Brazilian real (BRL), the central bank suggested:

- A commitment to intervene more aggressively through the end of next week (additional 20 billion through FX swaps).
- It is prepared to meet the market’s demand for USD through other tools as well as FX swaps (spot, credit lines).
- Intervention is a first line of defence and it has no intention of hiking rates just yet.

We continue to believe the central bank’s current monetary policy guidance, which places almost exclusive emphasis on inflation, clearly underestimates the (eventual) need to hike the SELIC rate. Should the BRL instability continue, a rate hike of 50-150bp could happen much sooner than expected, but the BRL may have to cross the 4.00 barrier first for the bank to start considering such drastic measures.