Ebury What borders?

G10 Weekly FX Update

Dollar sinks as European political worries ease

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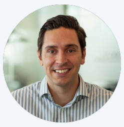
Dollar sinks as European political worries ease

Political fears eased last week as markets became less apprehensive about the French polls, sending risk assets and the euro up and the dollar down.



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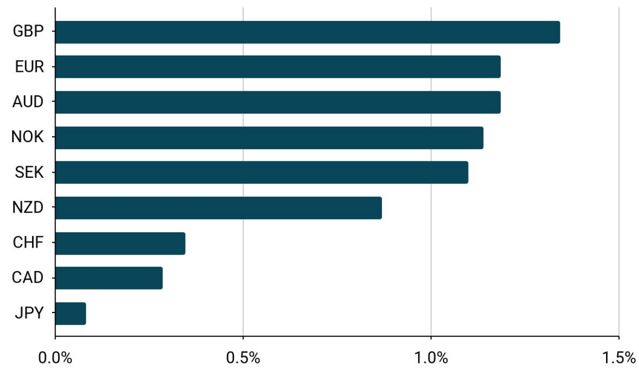
Highlights:

- ➢ Political risk premium in Europe is reduced but uncertainty remains after the 2nd round of voting in France.
- ➢ Dollar sells-off against all peers as economic data disappoints and risk sentiment improves.
- ➢ Speculation grows that Harris may replace Biden in a US presidential race.
- ➢ Labour won landslide victory in the UK election. GBP ignored the results.
- ➢ Safe-havens and CAD underperform.

The surprise victory by the left in the French National Assembly elections, however, has had little impact on markets so far. Investors seem to balance optimism about the National Front's defeat with worries about the leftist first place, leaving the euro largely unchanged from Friday's close, but significantly higher from the levels just after the calling of the election. More generally, dissipating political risk premia and continued softness in US economic data sent almost every major world currency higher against the US dollar.

Political uncertainty in the US about Biden's candidacy has yet to have a significant market impact. Focus will now shift to political horse-trading in the hung French Assembly, where right, left and centre are all very far from the numbers needed to govern. Attention on the economic front will shift from the apparent slowdown in US economic data to US inflation, as the June report is published on Thursday. Economists optimistically predict another 0.2% monthly increase in the core index that would signal a return to normality and the Fed's inflation targets, and allow the central bank to begin rate cuts after the summer.

Figure 1: G10 FX Performance Tracker [vs. USD] (1 week)



Source: Bloomberg Date: 08/07/2024

United States

USD

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It's perhaps a little too soon for FX markets to start pricing in the increased likelihood of a Trump victory in November, so the hints of softening in US economic data are driving markets. The payroll report for June contained more hints of a slowdown, as unemployment ticked up to 4.1%, prior job creation data was revised down, and wage growth slowed.

The data is not yet conclusive but together with the expected slowdown in June inflation does seem to free the Federal Reserve to cut rates twice in 2024, starting in September. If so, we would expect the dollar to give up some of its 2024 gains before the end of the year.

Euro Area

EUR

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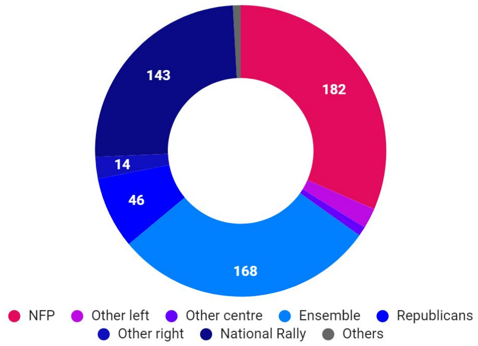
The common currency drifted higher all week in response to softer US labour data and hopes for a hung French assembly that would deny both far right and far left power. As for the latter, the actual results seem to have validated expectations, but the stronger-than-expected showing by the left may cap the euro rally in the short term.

Figure 2: French Election Second Round Results [seats]



Source: Le Monde Date: 08/07/2024

Domestic data had little impact on the common currency in recent days. A slightly more persistent than expected core inflation, which stabilised at 2.9%, does not change the overall picture significantly, with both markets and us pencilling in two ECB rate cuts before year-end. The economic and policy calendar in the Eurozone is sparse next week, so look for the euro to trade largely in reaction to French political headlines and the US inflation numbers on Thursday.

United Kingdom
GBP

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The widely expected huge Labour majority in the general election has been priced in by markets and had little visible impact on the pound. It must be noted that the UK first-past-the-post voting amplified its margin of victory, which in percentage terms was considerably smaller than what has been expected.

Attention now shifts back to the economy, with a slew of May data out on Wednesday, including industrial production and monthly GDP. Bank of England policymakers will also be speaking for the first time since the June meeting.

Japan
JPY

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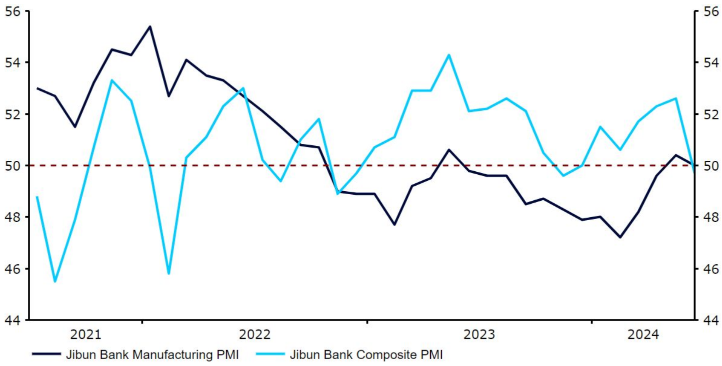
The yen seemingly cannot catch a break, with the Japanese currency sinking to fresh 38-year lows last week versus the broadly weaker dollar. Continued verbal intervention from Japanese authorities has so far been insufficient to allay the yen's slide. Finance Minister Shunichi Suzuki has continued to warn markets in recent weeks that direct FX intervention could be on the way, although this has not been forthcoming thus far.

Investors also remain doubtful as to whether the BoJ will hike rates at anything but a very gradual pace this year. Last week's data has not made a rapid policy normalisation any more likely, with the Jibun Bank composite PMI crashing back below 50 in June (49.7) for the first time since November. Attention today will be on the latest wage data for May - key for BoJ policy.

Figure 3: Japan Composite PMI (2021 - 2024)



Source: LSEG Datastream Date: 04/07/2024

Switzerland
CHF

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The Swiss franc continued depreciating against the broadly stronger euro last week, and the EUR/CHF pair is now back at 0.97, the level it was trading at in early June. Last week's economic activity data from Switzerland came in mixed. What stole the show was inflation. Instead of rising, its core measure fell from 1.3% to just 1.1%, working to push down the headline measure to 1.3%.

The impact of the release on the franc was short-lived. Nevertheless, subdued price pressures coupled with still unimpressive economic activity data support the case for further monetary policy easing. We think there is a good chance that the bank will reduce rates as soon as the next meeting in September. Markets now see a 50/50 chance of it happening then. With domestic calendar largely empty, the EUR/CHF pair may continue to react to shifts in sentiment in the coming days.

Australia
AUD

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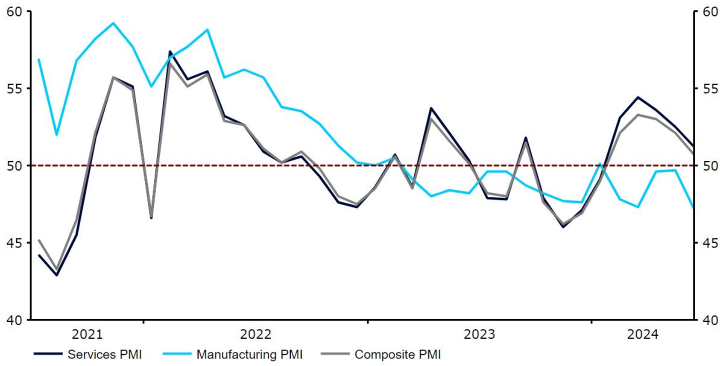
AUD posted fresh gains against most major currencies again last week, edging towards its highest level in six months on the greenback. Not only are markets pushing back their expected timing for RBA rate cuts, but swaps now see a 50% chance of another hike by year-end. News out last week will have strengthened the case for higher rates, as both the June services PMI (51.2) and May retail sales (+0.6% MoM) comfortably beat estimates. With domestic demand seemingly holding up well, and inflation not coming down at the pace that the RBA would like to see, we see risks to the Aussie dollar as skewed to the upside, particularly relative to its New Zealand counterpart.

Figure 4: Australia PMIs (2021 - 2024)



Source: LSEG Datastream Date: 01/07/2024

This week will be a quieter one in Australia, with consumer confidence data (Tuesday) and inflation expectations (Thursday) unlikely to rock the boat too much.

New Zealand

NZD

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The Reserve Bank of New Zealand look set to hold rates steady on Wednesday. Policymakers had previously indicated that they don't expect to begin lowering rates until H2 2025, but this is completely at odds with markets, which are pricing in the first rate reduction in October. We think that the balance of data, including last week's dire business confidence number, points to a much earlier start to easing than the RBNZ has outlined so far.

It will be interesting to see whether the bank hints at such this week. We suspect that Wednesday's meeting is probably too soon for any big shift in rhetoric, although any sign that the bank is increasingly concerned over the growth outlook could lead to some downside in the kiwi.

Canada

CAD

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The Canadian dollar followed the greenback last week, landing near the bottom of the G10 performance dashboard. Canadian economic data also had a similar flavour to that of the US, showing some deterioration. Employment unexpectedly fell by a net 1.4k, dragged down by another decline in full-time positions. The unemployment rate ticked more than expected to 6.4%, its highest level since January 2022. With time, this is likely to work towards easing wage pressures, but for now, they remain high: the average hourly wage rate actually increased substantially in June, to 5.6%.

Signs of a cooling labour market increased investors' confidence that the Bank of Canada will continue cutting interest rates. Investors are assigning a 60% implied probability of a second move in June and are now fully pricing in two rate reductions between now and year-end.

Sweden

SEK

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After some ups and downs, the Swedish krona ended last week little changed against the euro, as there were no major catalysts to move the currency.

This week, we could see more volatility in EUR/SEK, especially after the release of Sweden's June inflation data on Friday. Headline inflation is expected to fall for the fifth consecutive month (to 2.8%). This decline would support the Riksbank's dovish shift and pave the way for the two rate cuts signalled by the central bank at its last meeting. Moreover, according to the meeting minutes released last week, should the central bank see a clear downturn in the CPIF excluding energy in the coming months (with a favourable long-term inflation outlook), the probability of three cuts rather than two in the second half of the year will increase. In such case, the next cut is likely to occur in August. This week's inflation report may therefore be crucial for the Swedish krona.

Norway

NOK

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The Norwegian krone ended the week more or less where it started, trading around the 11.44 level against the euro. In the past two weeks, the krone has depreciated sharply against the euro, leaving behind the February highs. We attribute this fall in the currency to valuation, a possible rebalancing of positions after the strong rise in the krone in previous weeks, as the environment remains favourable for the NOK.

Increasing oil prices, which rose to their highest level since the end of April last week, have, however, limited further losses of the NOK. Norges Bank's hawkish stance should also support the Norwegian krone going forward, in our view. However, this could be put to the test on Wednesday, when the June inflation report is released. A significant fall in inflation could lead markets to bring forward the expected timing of rate cuts in Norway and trigger some retreat of the currency. Conversely, if inflation data beats expectations and falls less than expected, it would support the said Norges Bank's hawkish stance, thus propping up the currency. Be that as it may, it is a key data point at the moment and could lead to a spike in EUR/NOK volatility.

China

CNY

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The Chinese yuan ended the week nearly unchanged against the US dollar. Domestic data disappointed, with Caixin composite PMI showing an even sharper drop than the corresponding NBS index released earlier. While still positive, activity in the services sector hit an 8-month low (51.2). Recent activity data suggests momentum in the Chinese economy might be weakening.

This week, attention will be focused on inflation, with June report out on Wednesday. It will be followed by trade data, out Friday. Aside from the above, the countdown to the Third Plenum is on with this key gathering of political leadership scheduled to start next Monday. Investors have limited hopes, but any news will be closely watched and may impact Chinese markets early next week.

Economic Calendar.

08/07/2024 - 12/07/2024

Monday (08.07)		
Sentix Investor Confidence (July)	EUR	09:30
Tuesday (09.07)		
Fed Chair Powell Speech	USD	15:00
Wednesday (10.07)		
Inflation (June)	CNY	02:30
RBNZ Meeting	NZD	03:00
Inflation (June)	NOK	07:00
Thursday (11.07)		
GDP (May)	GBP	07:00
Inflation (June)	USD	13:30
Friday (12.07)		
Inflation (June)	SEK	07:00
Michigan Consumer Sentiment Index (July)	USD	15:00

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