Central banks to show their true dovish skin

This week will see three major central bank meetings, three potential tightening steps or messages and three unusual reactions in currency markets

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USD: FOMC reiterating independence may spur short-term USD interest

If there was ever a week to highlight how expected central bank policy moves do not drive currencies higher, then this is it. In this respect, the Bank of Japan and Bank of England policy meetings (Tuesday and Thursday, respectively) will probably be more exciting – given the possibility of policy disappointments relative to market expectations. As for the FOMC this week (Wednesday), it's hard to imagine a fairly unchanged statement giving short-term US rates – and the dollar – a fresh reason to move higher. The event could be made somewhat more interesting if the Fed felt the need to reiterate its independence (in either the statement or an additional notice) given recent comments by President Trump. Investors may see such a move as a statement of hawkish intent – reigniting a flattening bias in the US yield curve. This would also see a knee-jerk move higher in the USD – although the real focus in G10 FX space ahead of Friday's US jobs report will be data and policy events elsewhere. It's been a busy morning for the BoJ, which has had to step in and defend the 0% 10-year JGB yield target. This implies the BoJ won't rock the boat tomorrow.

EUR: Key eurozone data releases unlikely to shake dovish ECB expectations

We see another week of sideways trading in EUR/USD. While headline German (today) and eurozone (Tuesday) CPI readings are set to remain at the 2% target, we do not expect any major positive spillover into the EUR given the ECB's dovish forward guidance that was reiterated by ECB President Mario Draghi last week. With core CPI also set to remain around 1%, there is no rush for markets to price in a hawkish ECB stance just yet. The first look at 2Q18 eurozone GDP data (Tuesday) is likely to come in at 0.4% quarter on quarter – which is the same as during the first quarter. The potential for a bounce back has been pushed out to later this year – when we also see the EUR resuming its cyclical move up towards 1.30. Look for the 1.1550 support to hold.

GBP: Dovish BoE rate hike unlikely to spur hawkish spirit

A pound under the political cosh is unlikely to find much love from a dovish BoE rate hike this week; although we see the MPC delivering a 25 basis point rate hike at the 'Super Thursday' August BoE meeting, we think the potential for at least one, if not two, dissenters (Jon Cunliffe and Dave Ramsden) – as well as cautious rhetoric by Governor Mark Carney in the post-meeting press conference – may not necessarily engender much hawkish spirit in either UK rates or the pound this week, not least as both markets remain dominated by the risk of a no-deal Brexit. Indeed, hawkish BoE rhetoric alone is unlikely to elicit a steeper UK rate curve – and at best, we see the curve staying where it is or bull flattening. Our full BoE scenario analysis due later today will show how the skew of potential outcomes (risk-reward) favours a neutral to bearish GBP reaction following the event. The Bank of England not hiking this week would be the equivalent of pulling a rug from under GBP's feet (with GBP/USD falling to 1.2800/50 and EUR/GBP rallying to 0.90-0.91). The most likely market reaction is one resembling a 'dovish rate hike'; we feel the current political and broader economic environment will probably render any hawkish BoE assertions as incredible at this moment in time. In this case, look for a flat GBP following the BoE meeting – with risks of GBP/USD moving down to 1.30.