

FX Daily: Bank of England still averse to the dovish pivot?

We expect a 25bp hike (7-2 vote split) by the BoE today, in line with market pricing and consensus. Focus will be on new forecasts (especially 2-year CPI) and forward guidance. Despite a lot more tightening priced into the Sonia curve, the MPC may resist the temptation to push back against hawkish bets, and sterling may hold on to recent gains for a bit longer



Andrew Bailey,
governor of the Bank of
England

➔ USD: Glimmers of hope from April inflation report

Our economics team dissects yesterday's US inflation report [in this article](#), highlighting how price pressures remain elevated (another 0.4% month-on-month core print, in line with expectations), but also how there are some signs that service sector inflation is moderating, with used cars doing the heavy lifting in keeping prices sticky. With the Fed having focused on the ex-energy and ex-housing service inflation developments, markets probably read those encouraging signs and took the opportunity to increase their easing bets in the latter part of the year. Now, three full 25bp rate cuts are priced into the USD OIS curve by December.

Such a benign move in swaps and FX would have normally coincided with an improved

environment for equities, but stocks have struggled to recover, with stalling debt-limit negotiations in the US still weighing on sentiment. The market's sensitivity to this topic is growing each day and there may be growing fears that an adverse market event might be ultimately needed to break the political stalemate. Such a scenario would see a material upward correction in the dollar in the near term, even though the long-term outlook for the greenback would not really turn any less negative – in our view – given the prospect of large cuts by the Fed starting from late this year.

Today, PPI and jobless claims data, as well as speeches by FOMC members Neel Kashkari and Chris Waller will be in focus in the US. Still unstable risk sentiment suggests that any drops in the dollar may not have legs until there are positive developments on the debt-ceiling negotiations.

Francesco Pesole

➔ EUR: Contained impact from ECB speakers

European Central Bank speakers are the only highlight in an otherwise empty calendar in the eurozone in the second half of the week. The most prominent hawkish member, Isabel Schnabel is due to speak today, along with Pablo De Cos and Luis de Guindos.

However, the latest ECB remarks have not had a huge impact on the euro. After all, a 25bp hike in June is highly likely after President Christine Lagarde explicitly said the ECB is not pausing, and it is almost fully priced in; beyond that, there is around 22bp of additional tightening embedded into the EUR curve. The hawks are openly suggesting more hikes are possible beyond June, and the data-dependent approach (as well as common sense given still elevated inflation) is preventing the doves from explicitly calling for an end to the tightening cycle in June. Markets probably feel quite comfortable with the current pricing, and the euro's sensitivity to the September/October pricing has not been very high anyway.

Ultimately, EUR/USD remains a dollar – and primarily a US debt ceiling – story for now. There are downside risks that extend below the 1.0900 mark in our view in the coming days, and well below such level should money market liquidity start to dry up. That is not our base case, but a resolution to the debt-ceiling chaos may still follow a bumpy road and this does not appear to be the ideal time for a big rally above 1.1000 for the overbought EUR/USD.

Francesco Pesole

➔ GBP: Pound may hold on to gains after BoE hike

Markets approach the Bank of England decision day with rather aggressive pricing on future rate hikes. A 25bp move is fully priced in today, although the Sonia curve includes nearly two more 25bp increases before reaching the peak around September/November.

As discussed in our [BoE meeting preview](#), we think markets have got ahead of themselves, and today's 25bp hike (7-2 vote split, two members voting for no change) may well be the last one in this cycle. The main reasoning behind our conclusion is that the drivers of higher-than-projected inflation have primarily been food prices and some surprising stickiness in core goods inflation: neither of those trends look likely to be long-lasting, and we still forecast a fast deceleration in CPI later this year.

Some MPC members may definitely agree with us and expect this to be the last rate hike, but the question is whether they are ready to push back against market pricing and offer dovish hints to

the market just yet. Our suspicion is that they are not, and we think the BoE should keep the door open to more tightening if inflation proves “persistent”, essentially retaining a data-dependent approach. The new forecasts will also play a role in driving the market reaction: growth should be revised up, but inflation may be projected to fall below target in two years.

From an FX perspective, we do not expect this meeting to be a game-changer for sterling. We acknowledge that part of GBP’s recent strength has been due to the market’s aggressive expectations about BoE tightening, and therefore recognise there are downside risks as those (excessive, in our view) hawkish expectations are scaled back. However, we suspect the BoE will neither offer enough dovish hints today to trigger that dovish repricing, nor enough of a hawkish narrative to match the amount of tightening already priced into the GBP curve.

If anything, the balance of risks is skewed to the downside, but our call is for this meeting to have a relatively contained directional impact on the pound today. Cable may stabilise around 1.26 and EUR/GBP around 0.8700 for now.

Francesco Pesole

➔ CEE: Doves and hawks

In Poland, as expected, the National Bank of Poland left interest rates unchanged yesterday, but the main event is scheduled for today; a press conference by Governor Adam Glapinski at 3pm local time. The commentary following the May meeting hardly changed. It underlined the deterioration of the domestic economic situation, including declines in retail sales, industrial production and construction output on an annual basis in March. The main changes in the post-meeting statement concern the update on new data regarding the external and Polish economy, while the summary with policy guidance remained unchanged. In recent weeks, some of the Council, including its chairman, have again begun to suggest interest rate cuts before the end of 2023. This may be a harbinger of a slightly more dovish tone from Glapinski, although still with some caution. Yesterday, the Polish zloty moved to its strongest level since March last year. From a long-term perspective, the zloty still has a lot of room to catch up with the region in our view, but for today the dovish press conference should halt the current rally and return to 4.540 EUR/PLN.

In the Czech Republic, April inflation will be released today. We expect a jump from 15.0% to 13.5% year-on-year with risks seen to the downside. The Czech National Bank expects a decline to 13.2% in its new forecast. Later today we will see a government press conference at 11.55am local time where the austerity package for next year’s state budget is expected to be unveiled. Local media is talking about a CZK120bn (1.6% of GDP) deficit reduction, which is more than expected. Of this, 70bn is expected to be on the expenditure side and 50bn on the revenue side. From the Czech National Bank’s perspective, it will be interesting to see if the government wants to increase VAT, which was previously discussed. Meanwhile, the CNB deputy governor mentioned that such a move would be inflationary and would be a reason to hike interest rates. The 2y market rate differential reached its highest levels this week yesterday and the prospect of fiscal policy consolidation and a potential interest rate hike should be positive for the koruna, in our view. We expect the koruna to move into a 23.30-40 EUR/CZK range today.

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