

## FX Daily: ECB looking through higher wages

The dollar has had a good week ahead of the Memorial Day long weekend, and we still think USD/JPY can stay supported in the coming days. EUR/USD and EUR/GBP look, however, more likely to find some support than fall much further as the ECB's sanguine view on wages should not prevent further gradual shifts towards a less dovish narrative



The eurozone's wage growth drop is firming up expectations of a 25bp cut from the ECB next month

### ⬇️ USD: Growth convergence story losing steam

Hawkish Federal Reserve minutes and the consequent cooling off in global risk sentiment allowed for a moderate restrengthening of the dollar across the board, offsetting some domestic developments that – as in the case of EUR and GBP – pointed in the other direction. Today is the last trading session before a long weekend in the US, with markets closed on Monday for Memorial Day.

The data calendar has not been particularly busy in the US this week, although yesterday's positive surprise in the S&P Global PMIs endorsed the rebound in the dollar. Those are not as highly regarded as the ISM surveys but have the benefit of being more easily comparable across markets. The jump to 54.4 in the composite PMI puts the US back above the eurozone (52.3) and the UK (52.8), denting the recent narrative of converging growth outlooks across the Atlantic.

Today's key release in the US will be April's durable goods orders, which should come in on the soft side given indications from subdued manufacturing surveys and a sharp slowdown in Boeing aircraft orders. We'll also see the Kansas City Fed services survey later today. On the Fed side, Chris Waller will give a keynote address on the neutral rate, where he may add colour to his recent remarks on inflation and monetary policy, which were perceived as hawkish.

We don't see a strong argument for directional changes in the dollar crosses today. Domestic stories should remain central amid a relatively quiet US calendar and the Memorial Day break. We also maintain our bullish bias on USD/JPY as markets remain carry-oriented and the slowdown in Japan's core CPI (released overnight) endorses the rather cautious pricing for further Bank of Japan rate hikes (25bp by year-end). Markets should continue to test Japan's FX intervention tolerance, and a move to 158.0 looks very much possible in the coming days.

*Francesco Pesole*

## EUR: Watch for some hawkish comments today

Eurozone data has come predominantly on the hawkish side for the European Central Bank this week. Yesterday's good PMIs pointed to further growth momentum, and negotiated wages surprisingly accelerated from 4.5% to 4.7% year-on-year in the first quarter. The latter had long been seen as a make-or-break data point for a June rate cut, but ECB communication has now made a June move close to a done deal, and the ECB was oddly quick to publish a [blog post](#) to play down concerns on rebounding wages. The post stressed how one-off payments boosted the figure in the first quarter, and that a broader set of indicators point firmly to wage pressure deceleration in 2024.

The ECB's "rectification" on wages means the chances of a rate cut being delayed beyond June remain small, even if next week's CPI comes in a bit hotter than expected. At the same time, the chances of a more hawkish tone from the ECB at the June meeting have undoubtedly increased.

Today, the main things to watch in the eurozone calendar are remarks from some of the ECB's hawkish heavy hitters: Isabel Schnabel, Madis Muller, and Joachim Nagel. We wouldn't be surprised if they attempted to take the narrative further to the hawkish end for post-June policy plans after the latest data.

EUR/USD is testing the 1.0800 support this morning and remains predominantly driven by dollar dynamics. The next big event for the pair is in one week with the US core PCE data print, which should have a bigger impact than eurozone CPI, in our view. Still, given the risk of some hotter eurozone inflation and markets having shown a tendency to look on the brighter side of US price dynamics of late, the coming days may revamp some bullish sentiment on EUR/USD. A return to 1.0900 seems more likely than a drop to 1.0700 in the near term.

*Francesco Pesole*

## GBP: EUR/GBP looks cheap

EUR/GBP has found some support close to the key 0.8500 level and is trading on the strong side this morning after UK retail sales came in lower than expected this morning. The April print showed headline sales falling 2.7% YoY and the "ex-auto fuel" gauge -2.0%. March figures were also revised lower. This morning's data follows a generally soft UK PMI report yesterday, where the rebound in

manufacturing failed to prevent a service-driven drop in the composite index to 52.8.

The pound is looking expensive vs the euro at current levels, in our view. The big hawkish repricing in the Sonia curve appears overdone given the hotter-than-expected May services CPI is partly attributed to one-off factors, and we have seen signs of a dovish shift in the Bank of England's MPC balance. Markets are pricing in only 33bp of easing by year-end and less than 10bp for the August meeting. We still expect an August cut, and see any views for delayed easing due to the UK vote as misplaced – more discussion on the election in [this note](#).

Given the risks of the EUR:GBP short-term swap rate gap moving in favour of the euro (hawkish ECB cut and BoE cutting in August), and adding the risks of some small political risk premium being priced into sterling ahead of the July vote, we remain comfortable with our view that EUR/GBP will be heading higher beyond the short term.

*Francesco Pesole*

## ➔ CEE: FX remains sensitive to sell-off

As expected, Turkey's central bank [left rates unchanged at 50%](#) yesterday while retaining a tightening bias in forward guidance. The CBT also announced macroprudential and liquidity tightening moves following the recent developments in credit growth and deposits and to mop up excess liquidity in the system. Our forecast here remains unchanged with expectations of a first rate cut at year-end. In Poland, retail sales data disappointed in April after stronger industry data released on Wednesday. Overall, however, we remain optimistic about a recovery in the second quarter.

The end of the week in the CEE region should be rather quieter compared to previous days. The calendar will only offer data from the Hungarian labour market. In the FX market, after Wednesday's sign of weakness in regional currencies, Thursday saw a return to stability. However, we remain alert and open to possible further weakness in the region in the days ahead. The earlier rally seems to us to have left CEE FX overbought and vulnerable to profit-taking deepening any losses.

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