

## FX Daily: GBP - Mann plays the currency card

In quiet markets on Monday, comments from UK MPC member Catherine Mann drew attention. She said that the BoE falling behind Fed tightening could leave GBP/USD vulnerable and add to inflation. We know that a central bank cannot target inflation and the exchange rate at the same time. Yet the BoE may be happy to let aggressive tightening expectations remain



Source: iStock

### 📉 USD: Some calm is restored

After a riotous week in FX and debt markets, a little calm seems restored this week. Asian equities are a sea of light green and the dollar is mixed to gently offered. US yields are gently rising again. That looks like the right response to news from President Biden that the US may look at a temporary tax holiday on gasoline. Here, governments are using their fiscal leeway to ease some of the consumer pain felt by high energy prices. Measures like these have already been underway for some time - especially in eastern Europe.

Looser fiscal policy could provide more room for central bankers to ride out the inflation storm with higher rates and a loose fiscal, tight monetary policy mix is generally good news for a currency. Let's see how this gasoline tax holiday story develops and what size of fiscal stimulus it represents. This should be another factor keeping the dollar strong this summer.

For today, the US data calendar sees May existing home sales and Fed speakers Tom Barkin and Loretta Mester. Existing home sales are expected to have softened again, though investors may be reluctant to take US interest rates much lower on the move having been caught out by playing the 'Fed pause' earlier this month. Expect DXY to trade well within the confines of last week's wild 103.40 to 105.80 wild range. The next big dollar input will be when Fed Chair Jerome Powell delivers his semi-annual monetary policy testimony to the Senate - which judging from the latest FOMC meeting should be pretty hawkish and means that any dollar downside today is likely to be limited.

## ➔ EUR: April current account serves as a reminder

EUR/USD is consolidating near 1.05 and is looking for a fresh catalyst. Some calm has been restored to European bond markets, where the European Central Bank's promise of a new anti-fragmentation tool seems to have been enough to restore confidence in peripheral bonds. The 10-year Italian BTP-Bund spread has narrowed to 195bp from 242bp a week ago. Do not expect that to help EUR/CHF, however, which is now being guided lower by the Swiss National Bank.

Of interest today could be the eurozone current account release for April. In March this had fallen into its first monthly deficit since 2011. The seasonally-adjusted trade balance for April has already been released at a staggering EUR32bn deficit and a sharp widening of the current account deficit seems likely today. This should serve as a reminder that the eurozone's negative income shock on the back of the war in Ukraine has damaged the euro's fair value. At 1.05, EUR/USD is not particularly cheap based on our [medium-term fair value models](#) - and could go below parity were conditions to deteriorate further.

1.0400-1.0600 looks like the near-term EUR/USD trading range, with rallies likely to be limited ahead of tomorrow's Senate testimony from Powell.

## ➔ GBP: BoE cannot target inflation and the exchange rate at the same time

UK MPC member Catherine Mann grabbed headlines yesterday by suggesting that the BoE's failure to match Fed tightening could leave GBP/USD vulnerable and add to inflationary pressure in the UK. We had felt that was the BoE's implicit position last autumn with higher gas prices, although the explicit link to exchange rates was never made by the BoE.

What to make of Mann's remarks? She was one of three voting for a 50bp hike at last week's BoE meeting and the fact that the BoE concluded its MPC statement by dangling the need for more forceful tightening suggests the majority may be leaning, just slightly, in her direction. Yet we know that a central bank cannot target inflation and the exchange rate at the same time and thus will not be blindly hiking more aggressively if cable were to break below 1.20.

What it may suggest, however, is that the BoE may be happy to stay silent and allow BoE tightening expectations to drift around with those of the Fed. And it suggests the BoE may postpone what we call the 'day of reckoning' when it wants to re-align BoE tightening expectations with its own (we think more dovish) path. Mann's comments - and the sensitivity shown to FX - suggest that the MPC may not want to aggressively correct market expectations at the August rate meeting after all.

Cable can trade in a 1.2170-1.2300 range for the time being.

## **MXN: Peso would be our preferred carry currency**

Emerging market FX has had a rough few weeks on the back of the sharp jump in US rates. Encouragingly, the Mexican peso has been performing quite well. It seems to have been insulated by remarks from Banxico that it would have to tighten 'more forcefully'. Many other central banks around the world have picked up on that phrase over the last month.

The test of Banxico's rhetoric comes at Thursday's rate meeting where Banxico is expected to match the Fed with a 75bp hike and take the policy rate to 7.75%. MXN 3m implied yields are now over 9% as well. If there are brief periods of calm in financial markets such that carry trade strategies can win out, we see the Mexican peso as an outperformer here.

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