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## FX Daily: How “contagious” are Sintra’s hawks?

The ECB’s message in Sintra has been firmly hawkish and has helped the euro. Today, a panel with Lagarde, Powell, Bailey and the BoJ’s Ueda will tell us if other major central banks will follow such hawkish rhetoric. It should be the case for Powell (backed by strong data) and Bailey (too early to push back against hike bets), but is Ueda ready to talk up the yen?



Source: Shutterstock

### ↑ USD: Room for rebound

The dollar has traded on the soft side since the start of the week, but US data has come in on the strong side, which makes us reluctant to think the dollar has much further to fall in the second half of the week and ahead of today’s Sintra speech by Federal Reserve Chair Jerome Powell.

Yesterday, all US data releases beat consensus. Durable goods orders rose in May despite expectations for a drop and the S&P Case Shiller US house price index rose for a third month in a row in April as tight supply keeps prices supported despite weak buyer demand in response to surging mortgage rates. Home sales also rose more than expected and consumer confidence jumped to 109.7, the highest since January 2022 (despite being considerably below

pre-pandemic levels). Today, the US data calendar is lighter: MBA mortgage applications and wholesale inventories.

While those are not the set of data points either the markets or the Fed primarily focus on, they surely point to some resilience in key parts of the US economy and would underpin a reiteration of a hawkish message by Powell today. That would probably take the shape of a further endorsement of dot plot rate hike projections (two more before the peak) with potentially an additional pushback against rate cuts.

Markets continue to price only another 28bp of tightening and a 73% implied probability of a July hike, so there is still ample room for a hawkish repricing in the USD curve. We'd be cautious when jumping on a dollar bear trend before the data gives a more solid basis to justify the market's dot plot gap.

*Francesco Pesole*

### 📉 EUR: Sintra's effect may not last too long

President Christine Lagarde and other European Central Bank officials continued to signal more tightening ahead at the Sintra symposium yesterday. Markets received some more detailed inputs from other Governing Council members aside from Lagarde herself. For example, Belgian central bank chief Pierre Wunsch said the next three inflation readings will need to “give a clear signal that core is indeed going down” to convince the ECB to pause. Latvian hawk Martins Kazaks said earlier that the slowdown in the eurozone economy is not enough to bring inflation down and also explicitly pushed back against rate cut expectations before mid-2024.

A newswire report this morning suggested that some hawkish members are considering a faster reduction of the Bank's bond portfolio, shifting to a phase of active bond sales of assets. The euro's reaction to the news was limited: we'll see whether this has any impact on peripheral spreads when European markets open.

On the dovish front, Fabio Panetta is set to move from the ECB Executive Board to the Governing Council as he replaces Ignazio Visco as Bank of Italy governor. Panetta has stood out as an even more dovish voice than Visco (Italian members have generally swung on the dovish side), although that hardly changes the balance at all within the GC at this particular point in time.

Today, we'll see Italy release June CPI numbers, ahead of other member countries' and eurozone-wide figures tomorrow. Lagarde is set to deliver another speech in Sintra, and markets will keep an eye on more side-line comments by other officials. The euro has been on the strong foot, but a sustainable rally above 1.10 may be premature considering markets are already fully pricing in two hikes by the ECB and the risks of an upside correction in the dollar are non-negligible.

*Francesco Pesole*

### ➔ **GBP: Bailey may not offer any rate pushback**

Bank of England Governor Andrew Bailey (in the same panel with Lagarde and Powell) and Chief Economist Huw Pill will speak in Sintra today, and, like in recent circumstances, they are facing the pressure of very aggressive market pricing for BoE tightening. The Sonia curve is pricing in 118bp of additional hikes ahead, with a peak rate now seen closer to 6.25% than 6.0%.

The question is, once again, whether BoE officials will offer any kind of pushback against those tightening expectations, perhaps to offer some respite to the troubled UK mortgage market. That hardly seems like a logical move in our view after the hawkish 50bp hike last week and before having seen evidence that price pressures are abating at all. Arguably, the bar for a hawkish surprise is also quite high, but markets have shown some clear lenience towards hawkish BoE repricing, and we could see the short-term GBP rates staying supported barring any dovish hints by Bailey or Pill.

EUR/GBP should, in such an environment, remain quite depressed, and we could see it struggle to sustain a rally beyond the 0.8620/30 area.

*Francesco Pesole*

### ➔ **JPY: Any surprises, Mr. Ueda?**

A packed agenda of central bank speakers in Sintra today includes Bank of Japan Governor Kazuo Ueda, who will join the policy panel with Lagarde, Powell and Bailey. The speech will come at a time when the market's focus on the yen is on the rise again: USD/JPY traded above 144.00 yesterday, and is rapidly approaching the 145 area which is seen as a potential line in the sand for FX intervention by Japanese authorities.

Overnight, Japan's top currency official, Masato Kanda, stepped in with a verbal "protest", saying that authorities are ready to intervene if there are excessive FX moves, but USD/JPY is facing fresh upward pressure this morning and today, hawkish comments by Powell, backed by the solid US data seen so far this week, could easily take the pair closer to 145.00.

There is a possibility that Ueda will use Sintra as a stage to try and offer some verbal support to the yen, although the sustainability of that as a supporting narrative for the yen is up for debate. Any hawkish tilt in Ueda's resolutely loose policy stance would surely have a more far-reaching impact on the currency: we do not exclude that this could happen at the July BoJ meeting, but is Ueda ready to tweak his narrative today? The probability is arguably pretty low, but with very little priced in, the bar for any hawkish surprise is also quite low.

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