

## FX Daily: Inflation remains the market's priority

Events in Russia have had little discernible impact on the FX market so far. Instead, the hot topic of high inflation and what policymakers are prepared to do about it remains the market's priority. This will be at the top of the agenda at this week's ECB's annual symposium in Sintra. Expect another mixed week in FX markets and possible BoJ intervention



### ➔ USD: Geopolitics has yet to make its mark

Events in Russia this weekend have so far had very little impact on global financial markets. There has been no flight to quality rush into the short end of the US Treasury market (two-year yields are down only 2bp since Friday), crude oil could not hold onto some very modest gains in Asia, and Asian equity price action was muted. In FX, it is hard to discern any flight to quality into the dollar, nor discernible outperformance of defensive currencies like the Japanese yen and the Swiss franc. The muted response probably reflects i) a lack of clarity over what comes next after this challenge to President Putin's authority and ii) financial markets having already experienced a year of a stronger dollar and higher energy prices after the Russian invasion of Ukraine.

Instead, the market is very much focused on inflation. Both central bankers and governments are under fire for having kept monetary and fiscal policy respectively too loose for too long. These (or at least monetary policy anyway) will be the hot topic for this week at the ECB annual symposium in Sintra. Many of the G7 central bank governors are in attendance and presumably will deliver a hawkish message, similar to the one that Federal Reserve Chair Jerome Powell delivered to Congress last week.

This means that yield curves look to remain very inverted as investors assess the degree of looming recession and that the dollar will stay strong against those currencies without a monetary defence – i.e., USD/JPY stays bid. In addition to Powell's comment at Sintra on Wednesday, the US highlight this week will be the release of the core PCE inflation data for May. This is released on Friday. Expected at 0.4% month-on-month, another high reading for core inflation suggests there can be no let-up in the Fed's hawkishness.

DXY can probably bounce around in a 102.00-103.00 range this week, while USD/JPY should edge closer to the 145 intervention zone.

*Chris Turner*

## ➔ EUR: German IFO can keep the euro subdued

Friday saw a [soft set of PMIs across Europe](#), where the services sector dipped worryingly towards the gloom already felt in the manufacturing sector. This data set knocked about 50 pips off EUR/USD at the time of the release. Germany's June IFO today could also see a downside surprise and prompt another dip in EUR/USD back below 1.0900.

On the surface, the narrative of central bankers needing to keep higher rates for longer is not a good one for the pro-cyclical euro. However, a hawkish ECB has provided some defence against high US interest rates and has driven EUR/USD back above 1.09 – it will also firm up expectations of at least two more 25bp hikes (in July and September) and perhaps push back against some of the modest easing expected in 2024.

This environment tends to favour the continuation of a 1.0850-1.1000 range trade for EUR/USD and the goldilocks scenario of soft landing/softer Fed policy looks to be delayed further.

Elsewhere this week look out for a [Riksbank rate meeting](#) on Thursday. Unless it delivers a hawkish hike, EUR/SEK will head back above 11.80.

*Chris Turner*

## ➔ GBP: No push back against 6%+ Bank Rate this week

There is much discussion in the financial press about central bankers having seen the 'easy', base effect-driven decline in headline inflation. But now they are into the hard yards of getting core inflation down from around 5% – or in the Bank of England's case 7%. In this environment, we should expect no pushback from BoE officials on the pricing of the Bank Rate above 6% early next year. Equally, we expect the government to yield no ground on mortgage interest relief, which would only make the BoE's job harder.

EUR/GBP fell on the back of the Eurozone PMI dip last Friday. Despite UK hard landing fears, we are sticking with the initial views we put out in our latest [BoE reaction piece](#). Namely, that a very

inverted yield curve probably trumps hard landing fears and that sterling holds onto recent gains for the time being.

On this week's UK calendar is primarily BoE speakers, where Wednesday looks to be the main Sintra event for BoE Governor Andrew Bailey. EUR/GBP can drift back to 0.8520 this week, while GBP/USD should find demand under 1.27.

*Chris Turner*

## 📉 JPY: USD/JPY closing in on intervention

The strong dollar environment keeps USD/JPY grinding higher and approaching the 145 area, where Japanese authorities sold FX last September. True to form, top finance officials in Tokyo are working through their handbook of verbal intervention and look only a few steps away from being ready to pull the trigger.

Last autumn's Japanese FX intervention was well timed in that it shortly preceded a turn lower in US inflation and a reversal in the strong dollar. The risk of intervention now, however, is that US inflation stays sticky and that Tokyo is drawn out into a long battle against USD/JPY in the 145/150 area. We do think USD/JPY goes lower later this year on a turn in the dollar, but over the coming month, we can see USD/JPY sharply bouncing around in a 140-145 range – suggesting that short-dated USD/JPY option volatility is priced a little too low.

*Chris Turner*

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