# FX Daily: Powell set to sail FX markets into the next data releases

Fed Chair Powell starts two days of Congress testimony today. Based on last week's post-FOMC comments, we suspect he will focus on pushing back against rate cut expectations. A successful hawkish message could give the dollar some support into the next key releases. In the UK, another inflation surprise leaves few doubts about a hawkish BoE hike tomorrow.


Federal Reserve Chair Jerome Powell

## USD: Expect Powell to focus on rate cuts, not rate hikes

Fed Chair Jerome Powell will face Congress today and tomorrow (House Financial Services Panel first, Senate Banking Panel then) and will be extensively questioned about the path of monetary policy in light of recent inflation and jobs developments. It is a good opportunity to fine-tune a policy message that appeared slightly muffled by a rather aggressive set of Dot Plot projections, which are still largely disregarded by the market: the OIS curve price in 24bp to a peak, while the median Dot Plot signalled two more rate hikes this year.

Powell himself seemed reluctant to put excessive weight on Dot Plot projections last week, and instead focused on pushing back against rate cut expectations. We would be surprised to hear anything less resolute on easing speculation at this round of Congress testimony. Remember Powell said rate cuts are “a couple years out” last Wednesday: at the moment, the difference between the 3 months (peak rate) and the 1-year OIS implied yield is -64bp, which is the magnitude of easing currently expected in the next twelve months.

Should Powell successfully force a hawkish retuning of rate cut expectations around the one-year tenor, expect some dollar gains across the board. As discussed in yesterday’s daily note, the dollar appears trapped between the supportive highly inverted yield curve and the unsupportive rally in equities. Stock price sensitivity to the prospect of monetary easing down the road means, however, that Powell testimony can have important implications for equities too.

A successful rate-cut pushback this week by Powell can offer the dollar some support in the near term, but the greenback is set to remain overwhelmingly more sensitive to data as market pricing remains un-anchored from the Fed’s Dot Plot projections for the next rate hikes. Still, the first week of July is when we’ll get the most important set of data releases in the US, so Powell’s words can determine whether DXY will end the quarter above or below the 102.00 mark.

*Francesco Pesole*

## EUR: Not much impact from post-meeting ECB communication

The week after an ECB meeting is generally used by members to fine-tune the Bank’s message, although we must note that the past two instances have seen somewhat limited impact from this post-meeting communication. That probably boils down to President Lagarde having gained market traction after some communication hiccups, and markets now having higher confidence on the press conference communication as opposed to post-meeting communication.

Yesterday, we heard some dovish comments by French Governor Villeroy, who said the ECB has completed most of its hiking cycle and further hikes would be less important and highly data-dependent. There were also remarks from the hawkish side of the spectrum, with Muller and Vujcic pointing to sticky core inflation and accepting hard landings as part of the inflation battle.

Today, we’ll hear from two prominent hawkish speakers, Schnabel and Nagel, as well as from Slovakia’s Kazimir (also a hawk). Still, expect the impact on EUR/USD to be secondary compared to Powell’s testimony: we see some downside risks for the pair today, which could move back to the 1.0850/1.0900 area.

Elsewhere, EUR/SEK touched record highs yesterday. This is hardly good news for the Riksbank a week before a pivotal policy meeting where the need to re-establish a united hawkish front to fight SEK weakness will need to be weighed against the negative implications for a the fragile real estate market. Here is our full Riksbank preview and EUR/SEK update.

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## GBP: Another inflation surprise

UK inflation surprised on the upside again in May. Core CPI unexpectedly rose from 6.8% to 7.1%, while the headline rate was unchanged at 8.7% despite consensus expecting a decline to 8.4%.

The reason for higher prices is in no small part because of outperformance in services inflation. This will likely concern the Bank of England hawks, and while the chances of a 50bp hike tomorrow still appear limited, this will probably encourage MPC members not to push back against the very aggressive market pricing for further Bank of England tightening. More in our BoE meeting preview.

The FX impact of the CPI surprise was interesting. Sterling jumped but then rapidly erased gains: this probably signals how the room for a further hawkish repricing in the Sonia curve is limited and so are the positive implications for sterling of more data surprises.

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## CEE: CNB will try to fight dovish market pricing

Industrial production, PPI and labour market data in Poland will be published today. We expect industrial production to have fallen by 2.0% yoy in May, less than the market expected. Industrial producer prices have slowed again from 6.8% to 4.7% YoY in our view, and we also pay attention to wage growth, which we see rising 13.0% YoY.

Later today we will see the decision of the Czech National Bank on rates and we expect these to remain unchanged. Reasons for hiking rates mentioned by the board have diminished in recent weeks and the main focus will be on the vote split. In May, three of the seven members voted for a hike. We expect some votes for a hike to remain for hawkish central bank communication. We expect a 5:2 vote split in the baseline scenario, however central bankers voting for a hike in May have not been very vocal of late and so it is hard to assess how they see weaker inflation or wage growth. Overall, the vote split will thus be the main question for Wednesday's meeting, which will determine the outcome. The governor will still be pushing a hawkish message of higher rates for longer, and premature pricing of rate cuts by the market. We see the first rate cut at the end of the year.

The Czech koruna has been weaker than expected in recent weeks. We still expect the koruna to return to stronger levels. On a global level, the koruna should benefit most in a rebound in EUR/USD, while the CNB will try to postpone dovish market pricing, which should support interest rate differentials. Market positioning is rather light comparted to PLN and HUF. We expect the koruna to return below EUR/CZK 23.70.

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