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Article

G10 FX: Testing the Phillips Curve

Yellen and US data to see global bond market sell-off continue this week. Dovish BoC rate hike and soft UK wages suggest downside risks to CAD and GBP

Content

Theme of the week: US data & Yellen to see bond-market sell-off continue

Global markets have been characterised by the theme of rising bond yields and we expect this to continue in the week ahead. While the recent driving force has been the break out in 10-year Bund yields, catalysts this week stem from the US. Both robust US inflation data (Fri) – as well as Chair Yellen raising the prospects of a September start to the Fed balance sheet run-off process at her testimony to Congress (Wed) – should see a continuation of the steepening bias in global yield curves.

A higher USD/JPY is our preferred way to play any short-term US data rebound theme, though the negative correlation between bond yields and equities – consistent with a global monetary tightening shock – will need some monitoring. A sharper bond market rout could see a more pronounced correction in equity markets that weighs on risk appetite, especially given that those global 'animal spirits' seen earlier in the year are less obvious at present.

> Dollar index (DXY) to remain above 96

EUR: Solid US data may keep EUR/USD this side of 1.15 for the time being

The Eurozone calendar is relatively quiet in terms of data and ECB speakers this week, with all the action coming out of the US. In Sweden, there's a crucial CPI release (Wed); after the Riksbank's dovish disappointment, any positive inflation surprise could see EUR/SEK technically breaking down to the 9.55 area.

GBP: Little signs of wage growth could trigger a dovish BoE reality check

This week's UK labour market report (Wed) is likely to come as a disappointment to MPC hawks banking on the Phillips Curve – that is low unemployment rates translating into higher labour costs – to come good. While job gains are likely to remain resilient (ING: +127k), a slowdown in headline wage growth to 1.8% will add little macro support to calls for a Nov BoE rate hike. With markets still pricing in around a 45% chance of a rate hike later this year, we continue to believe that a dovish re-pricing – and a move lower in short-term UK rates – remains the key downside risk to GBP in the near-term. BoE watchers will also be noting Deputy Governor Ben Broadbent's speech this week (Tue); we suspect his remarks will be more representative of the 'core' MPC views, which seem aligned to the idea that a realistic rate hike debate is more of a 2018 story.

1.2780

GBP/USD could test this level if markets price out a 2017 BoE rate hike

CAD: Risk-reward favours USD/CAD upside ahead of a big BoC meeting

Markets now see a 25bp BoC rate hike (Wed) as a formality after the latest jobs data, which may support the central bank's more constructive (forward-looking) view on the output gap. Still, the CAD OIS curve pricing in close to ~100bp worth of tightening over a 2Y horizon looks a bit extreme at this stage; we see the most probabilistic outcome being a dovish hike – with any forward guidance signalling a very shallow hiking cycle. However, given that this CAD rally has been too fast, too furious for the economy's liking, we wouldn't rule out a surprise hold. Either way, a buy the rumour, sell the fact reaction – should push USD/CAD back to 1.30.

93%

The odds priced into markets of a Bank of Canada July rate hike