



## FX Daily

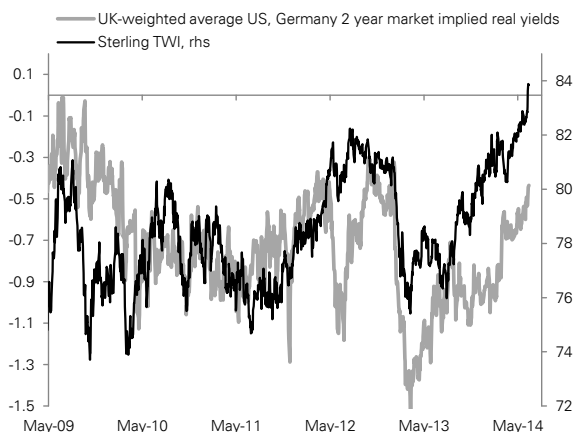
# The calm after the Carnayage

Governor Carney's speech led to a large repricing of front-end UK rates last week, with expectations of the first hike brought forward to December 2014 (from March 2015 prior) and two now priced by May '15. Correspondingly, GBP/USD flirted with recent highs, and EUR/GBP made new cyclical lows. Now that the dust has settled, however, further near term gains from monetary policy repricing should be limited.

First, the pound is already leading moves in real yields (chart 1), which partly explains why the follow through in price action has been somewhat disappointing (compare the sub-1% gains of GBP vs. EUR and USD to the plus 1.5% NZD made after last week's RBNZ MPS). Second, it is hard to see timing getting any more aggressive with two hikes now fully priced before the general election. Third, the shift in the front end was not reflected down the rest of the curve, consistent with a lower for longer outlook. Correlating GBP to different overnight rate tenors suggest that it is the pace and size of hikes, rather than their timing, which matter (chart 2).

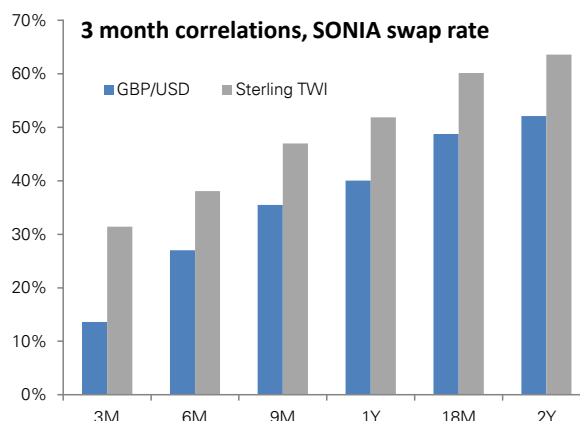
In this sense, modifications to guidance in the minutes and Inflation Report that rate hikes will be 'gradual' and the base rate will 'remain below average levels for some time,' would be the next step in changing expectations. However, there are reasons to think the BoE will be cautious. First, Carney may have achieved his goal of introducing more volatility in rates last Thursday, but is unlikely to want to compound the reaction. Second, despite strong employment, wage growth shows no sign of materializing. Last week's earnings numbers were soft, even excluding base effects. Third, changes to the MPC should favor conservatism given the relative lack of experience of the newcomers. Fourth, tomorrow's FPC meeting may result in further measures for housing (tightened underwriting standards the most likely outcome, caps to LTV and LTI ratios more brutally effective but politically difficult when the decision is announced on the 26th). Carney has said this would not influence monetary policy, but it may have knock-on consequences for growth (last night's Rightmove index, the first for June, showed material slowing in house prices reflecting leading indicators). Taking into account positioning remains stretched and political risks un-priced, we retain our bearish GBP/USD call, targeting 1.60, but with a stop at 1.73 should the cycle surprise again to the upside.

GBP leading the moves in real rates



Source: Deutsche Bank, Bloomberg Finance LP

For sterling, the pace of hikes matters more than timing



Source: Deutsche Bank, Bloomberg Finance LP and DB research