FX Daily: 7% inflation to help build a floor under the dollar

The dollar's under pressure after Fed Chair, Jerome Powell's comments in the Senate. Today, inflation hitting 7% in the US shouldn't come as a big surprise but equally, it may help build a floor under the USD in the near term and possibly avert a break above its recent EUR/USD range. Elsewhere, GBP may continue to ignore the political noise

Jerome Powell at a Senate confirmation hearing yesterday

USD: Rising inflation still helping the strong dollar case

Yesterday's Senate hearing by Powell was a miss for hawkish expectations. Between the reiteration that the FOMC won't allow inflation to become "entrenched" and the reassurance that the base case scenario is still for inflation to peak in mid-2022, a market that was already pricing in three and a half hikes by the end of 2022 unsurprisingly gave a greater weight to the latter message by Powell. The overbought dollar came under pressure across the board, with the benign impact of Powell's remarks on equities pairing with a rally in oil to send commodity currencies higher.

Today, the focus will shift back to data, with US headline inflation that should reach 7% and the core rate likely to advance well into the 5% area in the December readings. Barring a significant upside surprise, a break above 7% is expected by the market and the immediate FX reaction may be contained. At the same time, it should allow consolidation for a floor below the dollar in the near term – further cementing expectations for three Fed hikes and leaving the door open to speculate for four in 2022. We think this is a reason for markets to keep buying the dips in the dollar for the time being.

This late afternoon, keep an eye on the Fed's Beige Book release, as well as remarks on the economic outlook by the generally quite dovish Neel Kashkari.

EUR: Close to a key level

The dollar's pullback sent EUR/USD near the top of its recent range. As highlighted above, we are inclined to think markets will keep buying the dips in the dollar, although a break above the key 1.1386 December 31st high today would likely challenge this view.

Yesterday, the new Bundesbank President, Joachim Nagel, expressed his concerns about inflation risks and expressed the view that recent price pressures are not entirely due to temporary factors. The consolidation of a hawkish front within the ECB's Governing Council clearly poses some risks to the gradual approach to policy normalisation championed by President Lagarde, although it still seems insufficient to give any real lift to the EUR for now.

GBP: Looking immune to political noise

Prime Minister Boris Johnson is still battling with claims he attended a party at Downing Street in May 2020 while social distancing rules were in place in the UK, and will face a parliament interrogation today. While arguably facing the toughest period of his tenure, markets seem very sceptical to price in any political instability in the UK for the moment, with the pound still scoring as the best performing currency of 2022.

Barring any surprise shake-up in the political picture or any policy remarks by Bank of England's Jon Cunliffe today at a crypto-related conference, we think the pound should continue to see no real domestic inputs.

We continue to favour EUR/GBP downside and a break below 0.8300 in the near term, and another good day for risk sentiment would likely help the higher-beta GBP gain some more ground.

CAD: A break below 1.2500 is not easy

USD/CAD broke below 1.2600 yesterday and is trading at the lowest levels since November. CAD has shown some good resilience to the unfavourable swings in risk sentiment – backed by oil prices trading again above 80$/bll and the prospect of Bank of Canada tightening. The second notion is certainly being challenged by the recent containment measures imposed in parts of the country, but for now, markets appear to count on the fact that the Canadian economy was in a very good spot – latest jobs data being a case in point – before the Omicron hit, and that has left BoC tightening expectations supported.

We think that the USD may rebound in the coming days and that means that a break below the key 200-d MA 1.2500 in USD/CAD would require some very positive external inputs – especially from the oil market.

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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