

## FX Daily: Calmer waters heading into a big week for central banks

US inflation ultimately had a very short-lived impact on the dollar, which found fresh support from shaky risk sentiment yesterday. Markets may however be cementing their view that Fed tapering will be delayed heading into next week's meeting, which may allow for a rangebound (and possibly mildly dollar-negative) environment in the rest of the week



### 📌 USD: The tapering dilemma is still there, but how much does it matter for the dollar?

A slightly below-consensus read in US inflation yesterday saw an initial negative reaction in the dollar, which however quickly reversed. Jitters in the stock market later in the day helped the dollar recover further, but it also appeared clear that the CPI read itself was not enough to trigger a break from the recent tight ranges in major dollar crosses.

Eventually, inflation numbers provided no answers to the market's dilemma around the timing of Fed tapering. The quick reverse in dollar weakness, however, could suggest that some short delay in the tapering announcement (i.e. in November instead of September) may not be enough to

generate a sustained dollar downtrend. After all, the dollar has recently received support from the narrative of a potential combination of monetary tightening and slowing growth in the medium term: it is no surprise that a marginal decrease in inflation did very little to ease such concerns.

Having digested the latest key piece of hard data before next week's FOMC meeting, the upcoming releases seem unlikely to drive any meaningful change in rate expectations, and by extension, the dollar. Still, the September Empire Manufacturing index as well as August's industrial production numbers will provide some extra measures about the impact of supply-chain disruptions today.

A likely quiet rest of the week for markets may fail to revive volatility in major USD crosses, and we expect a prevalence of range-bound trading. If anything, the risks for the dollar heading into next week's Fed meeting may be slightly tilted to the downside if markets cement their view that the tapering announcement will indeed be delayed and high-beta currencies may see room for some recovery after a possible overreaction to the move lower in US equities (and also on the back of that same view on tapering delay). But, as mentioned above, a sustained downward trend lasting multiple weeks in the dollar does not seem likely.

### ➔ **EUR: Still rangebound, keeping an eye on Lane's speech**

We did not expect EUR/USD to have enough fundamental support to move back in the upper-half of the 1.1800-1.1900 range, and this may well continue to be the case today, as any tick lower in the dollar thanks to sentiment improvement should see pro-cyclical currencies being the main beneficiaries rather than the euro. The calendar today includes the release of July's eurozone industrial production data and two scheduled ECB speakers: Executive Board member Isabel Schnabel and Chief Economist Philip Lane. The latter of these has the highest potential of moving the market, as Lane will discuss the ECB strategy review at a webinar, and may provide some hints about the stage of discussions about further stimulus unwinding. Our suspicion, here, is that any comments in this sense may fall more on the cautious side after the ECB took a step in the direction of tapering at the September meeting.

Hitting the headlines this morning is the pledge by Italian Prime Minister Mario Draghi to fight the rise in energy prices by using public funds. That may feed into the narrative of stark divergence between inflationary pressures in Germany compared to other eurozone countries - which appears quite central in the debate around unwinding the ECB QE - although the impact would naturally be limited to headline (and not core) inflation.

### ⬆️ **GBP: Spike in inflation should not matter much to the BoE**

UK inflation figures rebounded more than expected, as the headline rate touched 3.2% and core reached 3.1%. Above-3% inflation is inevitably feeding some more hawkish expectations at the Bank of England (which announces policy next week) and the pound may stay supported on the back of that in the first hours of European trading, with EUR/GBP possibly falling closer to the 0.8500 level. At the same time, we doubt that the short-term swings in inflation will be deemed anything more than transitory by the BoE, as the longer-term inflation outlook (for 2022-2023) should instead remain the main determinant.

### ⬆️ **CAD: Inflation read to cement BoC tapering expectations**

The Canadian dollar has shown some tentative signs of recovery at the start of this week, but yesterday's risk-off turn in global markets sent USD/CAD back to the 1.2700 level. We think political

uncertainty is currently taking a toll on CAD and partly explaining the divergence with the other oil-sensitive G10 currency, Norway's krone, which has instead found more solid support of late. We think CAD will struggle to stage a sustained rally before Monday's Federal election, when the emergence of a potential coalition may ease the negative drag of political noise on the currency.

Today, however, we could see some short-lived support to the loonie coming from August's inflation data. Consensus is looking at another increase in the headline rate, from 3.7% to 3.9%. We think that as long as inflation doesn't decelerate we'll see markets cement their view that the Bank of Canada will step in with a new round of tapering in October (our base case), as jobs data already seemed to offset the negative impact on rate expectations caused by the 2Q GDP contraction. As mentioned above, the impact should be positive on CAD today, but we think the proximity to the election (20 September) may keep CAD's upside capped in the rest of the week.

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