FX Daily: Central bank exit strategies starting to make their mark

FX markets like central bank stories re-iterating baseline views of a recovery. Arguably the same story has provided a little support to the EUR too. But will the Fed join them next week? It seems unlikely

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USD: The Fed won't be the first to turn the monetary taps off

This week has seen a couple of central banks, Norges Bank and Bank of Canada, re-iterate baseline views of a recovery which will allow 2022 rate hikes (Norway) or unused QE programmes (Canada). FX markets like these stories and have taken both these currencies a little higher. Arguably the same story (unused ECB PEPP) has provided a little support to the EUR too.

Will the Fed join them next week? That seems unlikely. Treasury Secretary nominee, Janet Yellen, is still talking about the risk of doing too little on the fiscal side and with a Fed very much focused on inclusive growth, it would seem unlikely that the Fed will want to generate any tighter financial conditions by shedding light on tapering plans – there's little to be gained for the Fed here. Reflationary Fed policy will remain a dollar negative. That is not to say we cannot see some more dollar consolidation.

The $/Asia decline has stalled ($/CNH seems bid below 6.45 now) and investors may start to focus on events in the US Senate, where both a Trump impeachment vote and a $1.9trn stimulus plan will be in focus. DXY may well trade a narrow 90.00-90.50 range.

EUR: PMIs and ECB professional forecast survey in focus

EUR/USD found some support from the ECB yesterday and the focus today will be both on the January PMIs and the ECB survey of professional forecasters.

On the former, consensus expects broad lockdown-driven falls in the composite PMIs led by services. On the survey side, the focus here will be on inflation expectations and presumably on how much the expectations of 1.3% in 2022 and 1.7% longer term change.

We're generally positive on EUR/$, but further consolidation could be seen. 1.21-1.22

GBP: Nissan news welcome to the UK

UK media is running with the story that Nissan will retain its car production plant in Sunderland after the Brexit deal – supporting 75,000 direct and indirect jobs.

Elsewhere lookout for UK January PMI today, potentially upsetting the GBP rally.

BRL: Fiscal pains re-surface

The BRL has been the emerging market under-performer over the last week and suffered a 3% intra-day sell-off yesterday amidst benign external conditions. Brazil may prove one of the front lines of investor concerns over Covid-19 fiscal challenges, where the frontrunner for the position of Senate President hinted that the spending cap could be suspended ahead of further support to those most in need.

The fiscal side has always been Brazil's achilles heel and despite the central bank turning more hawkish as Gustavo Rangel expected, it seems we may be entering a period where fiscal concerns dominate.

With the implied yield on the BRL 3m NDF only 1.4%, it may be time to increase BRL hedge ratios.

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com