FX Daily: Fresh tightening coming from Poland and Brazil today

Fears over the severity of the Omicron variant are starting to ease and have allowed a recovery in risk assets. A more pressing concern for central bankers remains inflation and today should see some further large interest rate hikes in Poland and Brazil. That the Fed is also concerned with inflation should limit USD downside ahead of the 15 Dec FOMC meeting.

USD: Slightly risk positive tone could see $ soften

Global equity investors have certainly taken a glass half full view of the world and chased equities higher on Tuesday on signs that the effects of Omicron might be less severe. That feels a little premature but perhaps owes to the fact that buyside surveys show that investors still have relatively high cash levels and want to put money to work.

With concerns just starting to ease over Omicron, attention in FX markets returns to the central bankers and how they plan to manage the growth versus inflation trade-off. We have three key central bank meetings today - Canada, Poland and Brazil. The market is expecting hikes in Poland and Brazil, while in Canada the central bank should continue to manage expectations towards a

2Q22 hike - see below.

Please see a detailed comment on Poland here. Another 50-75bp hike should keep the zloty relatively well supported and continue to drive cross rates like PLN/HUF higher still. In Brazil, a large 150bp selic rate hike is expected which will take the policy rate to 9.25%. Inflation is running close to 11% in Brazil and, as usual, the market will want to see how Brazil's central bank, BACEN, guides policy expectations for the next meeting. It probably is too early for BACEN to start talking of a slowdown in tightening and USD/BRL can continue its recent path of stability.

Elsewhere, commodity currencies have done better as risk appetite has improved and in Asia, USD/CNH is now down on support at 6.35. A break below there would be notable - and could send USD/ZAR lower too - and potentially send the dollar weaker across the board. A break lower in USD/CNH is far from given, though. We suspect Chinese policymakers prefer a stable USD/CNY as they try to protect SMEs from higher commodity prices. Having prevented USD/CNH from breaking above 6.50 this summer, the People's Bank of China may prefer that the 6.35 level holds now, too. Let's see. However, one of our preferred cross rates, CNH/INR, continues to move higher too.

What does this all mean for the dollar? We cannot rule out a little softness today on a pro-risk story and tightening elsewhere, but these same inflation concerns also now reside at the Federal Reserve. The 15 December FOMC meeting presents a clear bullish event risk for the dollar and thus any dollar downside, particularly against the euro and yen, should prove limited.

DXY to continue trading well within a 95.50-97.00 range, but perhaps with a slight downside bias today.

EUR: ECB speakers unlikely to move the needle

EUR/USD continues to oscillate well within a 1.1180-1.1380 trading range - a range which looks likely to hold into next week's FOMC meeting. There is not much European data to speak of today and instead, the focus will be on ECB speakers at a European Systemic Risk Board conference. This will be one of the last chances to hear from them ahead of next Thursday's (16th) ECB meeting, but it would prove something of a shock were the ECB to join the Fed and retire the 'transitory' description of inflation. ECB President Christine Lagarde speaks at 915CET and Isabel Schnabel at 1415CET.

Elsewhere in Europe, the Scandinavian currencies have been enjoying quite a comeback. The Norwegian krone is one of our preferred currencies for 2022. Look out for the US weekly oil crude inventory data at 1630CET. A larger drawdown than expected (consensus 1.1mn barrels) could see Brent further retrace the late November collapse and give the NOK a further nudge higher.

GBP: Political missteps

It is hard to say whether political missteps from the UK Conservative government are having any impact on the pound - though it does seem this issue of an ill-timed Christmas Party a year ago has further to run. In terms of the macro-central bank story, the market has not completely ruled out the chances of a Bank of England rate hike on 16 December and a BoE inflation attitudes survey released this Friday could prove telling and move GBP in thinning year-end markets.

Unless we hear any bombshells from ECB speakers today, we would expect EUR/GBP to trade in a 0.8500-0.8550 range.

CAD: Expecting limited impact from BoC meeting

The loonie has been rebounding strongly since the start of the week, and USD/CAD has now moved back below the 1.2700 mark. The Bank of Canada announces monetary policy today – here's our meeting preview - and a major focus will be on the Bank's assessment of the risks associated with the Omicron variant. We expect the BoC to keep its cautious language, but we doubt they will go as far as rethinking their policy tightening plans considering the ever-strengthening jobs and growth backdrop in Canada.

We think this will match market expectations and the announcement should have a limited impact on the Canadian dollar, which should remain almost solely driven by external factors (risk sentiment and oil prices). Considering the market is back to pricing five rate hikes in 2022 by the BoC, the bar for a hawkish surprise also appears to be quite high. Further improvements on Omicron-related sentiment may see USD/CAD extend its decline to 1.2500 by year-end.

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