FX Daily: Frothy

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USD: Rise in US yields prompts some dollar short covering

Monday is witnessing a corrective rally in the dollar as investors take stock of rising US yields, developments in Washington and generally frothy risk markets. On the subject of US yields it is worth noting that the entire rise in US Treasury yields this year looks to have been driven by the term premium – or the extra compensation investors require for an uncertain inflation or fiscal environment. That it is the term premium driving US yields rather than a re-assessment of Fed policy is important for our bearish dollar call. The former inserts a risk premium into US assets (arguably a dollar negative), while the latter would provide a more serious challenge to our dollar call. Fortunately, it seems far too early for the Fed to be talking about withdrawing stimulus. Indeed, we would expect a raft of Fed speakers this week to echo the central view that quantitative easing will continue at the same pace for a large part of the year. It is hard to completely rule out a corrective dollar recovery on the back of an adjustment in risk assets (Dow called 200 points lower), but the factors that are driving this powerful dollar bear trend (recovery hopes, Fed on hold) are still very much in place. For today, look out for whether the House wants to push ahead with impeachment of the President and what we can expect to hear on Thursday, when Biden's new team may clarify fresh stimulus plans. DXY corrective rally may well stall in the 90.50/91.00 area. We're bearish.

EUR: Limited dip

Barring an event that could trigger indiscriminate position adjustment, we think the EUR/USD correction will be reasonably shallow. A dip to 1.2130/50 may well meet buyers. Local highlights this week include European Central Bank minutes and what should be the first look at 4Q20 German GDP. Watch out for ECB President Christine Lagarde at 1240CET too.

GBP: Negative rate threat

Sterling will have to brace itself for another wave of negative rate headlines when the MPC's Silvana Tenreyro speaks on the subject at a 14CET event today. GBP will be vulnerable to negative rate talk during lockdowns and EUR/GBP risks 0.91.

CAD: BoC gets fresh survey evidence today

Today sees the release of both the Bank of Canada's quarterly business outlook survey and the consumer expectations survey. Despite the market very much fixated on inflation risks at the start of the year, we presume policy makers are much more interested in growth dynamics given the vulnerable nature of the recovery. The market looks in a mood to pounce on any negatives today, but speculators are not particularly long CAD right now and we suspect that levels over 1.28 may attract renewed dollar selling interest.

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