FX Daily: FX reserve adequacy back in focus

India joins the discussion on FX reserves, China's fourth quarter GDP is better than expected, and political developments in Italy and the US are in focus amid quiet trading

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USD: Reserve Bank of India latest to discuss FX reserve increase

The dollar is currently enjoying a limited corrective rally and that may be the tone for this week. In our G10 FX Week Ahead we highlight how some consolidation in the key $/Asia decline – despite better than expected China 4Q GDP data released overnight – probably means reduced dollar selling across the board. Away from Joe Biden's inauguration on Wednesday and today's US public holiday, the FX market is already starting to focus on Janet Yellen's confirmation hearing for Treasury Secretary in the Senate tomorrow. This is her opportunity to be asked about the dollar. No doubt she will emphasise that exchange rates are best set in the market – consistent with G20 commitments. It is important to remember, however, that the dollar is not down at these levels because the Administration wants a weaker dollar, but because the reflationary US policy mix of very negative real rates has brought it here. Elsewhere, we note that the Reserve Bank of India has joined the discussion on FX reserves, outlining that emerging market nations need to improve FX reserve adequacy levels to deal with shocks. These comments do put reserve managers on a collision course with the White House, which expects the dollar to be allowed to adjust lower as market conditions dictate. DXY could edge to 91.00 in quiet markets.

EUR: Weighed by Italian confidence vote

A period of dollar consolidation, a slow rollout of vaccines across the EU and a confidence vote in Italian parliament have combined to take the steam out of the EUR/USD rally. Over the next 48hrs, Italian politics will get a lot of airplay in that we see Prime Minister Giuseppe Conte's government facing a confidence vote in the Chamber of Deputies today and then in the Senate tomorrow. The market fallout of this political drama looks contained – largely through aggressive European Central Bank bond buying – but it could still be enough to see EUR/USD correct to the 1.1980/2000 area. Also look out for the ECB this week. The trade-weighted EUR is weaker but remarks such as the ECB 'monitoring exchange rates carefully' will add to the consolidative mood. Elsewhere, Angela Merkel's CDU party elected Armin Laschet as new leader.

GBP: Vaccine rollout gains momentum

News that the UK's vaccine rollout is advancing as planned continues to support the view that the UK could exit lockdown earlier than the continent. The Bank of England's Andrew Bailey speaks today – but on climate change not rates. EUR/GBP to 0.8860.

CAD: Keystone XL back in focus

Though not entirely unexpected, reports that Joe Biden plans to cancel the Keystone XL US-Canada oil pipeline on his first day in office have hit the Canadian dollar. USD/CAD could correct further to 1.2820/30 this week.

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