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FX Daily: Lacking catalysts to halt the dollar correction, for now

We think the ongoing dollar correction is temporary, but for today we could continue to see most G10 currencies (and especially the pro-cyclical ones) stay supported against the greenback, barring a worsening of the global risk environment. In Canada, inflation may accelerate further, but we think the BoC already has enough reasons to taper next week

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USD: Upbeat risk environment keeps endorsing a temporary dollar correction

The dollar has remained offered across the board this week, as markets appear to be taking advantage of a rather quiet US data calendar to square some long-USD positions, and also thanks to a benign risk environment, where a strong US earnings season has continued to offset inflation/monetary tightening concerns.

Today, focus in the US will be mostly central-bank related, as the Fed releases the Beige Book and FOMC member Randal Quarles (normally quite neutral in the dovish/hawkish spectrum) discusses the economic outlook at an event. At this stage, it looks like the dollar is lacking some catalysts to contain the ongoing correction, and any support to the greenback may need to come from a cool-off in the recent risk-on mood in markets.

The dollar's weakness is, like last week, mostly benefitting pro-cyclical currencies. Within this segment, AUD and NZD are emerging as the biggest winners, largely thanks to a) the further de-pricing of China-related downside risk; b) a spike in both countries' short-term yields, which was fuelled by a high 3Q inflation read in NZ; c) in the case of AUD, some squeezing of the overstretched net-short positions. Let's monitor whether the RBA steps in with some more seizable intervention to drive the yield on the April 2024 bond back to the YCC-targeted 0.10% (it is currently trading at 0.17%). In New Zealand, there may be some further room to rise for short-term yields, as markets may start to price in a 50bp hike in November following the 4.9% inflation read for 3Q. A continuation of the current risk-supportive environment should see AUD/USD and NZD/USD break above 0.7500 and 0.7200, respectively.

EUR: No room for ECB hawks

EUR/USD has continued to edge higher on the back of USD weakness, but we think the rally in the EUR may lose steam before other G10 currencies, largely because the EUR does not appear in a position to truly benefit from the recent market dynamics. The energy-importing eurozone looks set to pay a high price from the energy supply crisis and the ECB has continued to push back against any hawkish speculation, despite upside risks to the inflation outlook.

Yesterday, Philip Lane suggested how markets (that are currently pricing a 10bp ECB hike in September 2022) may be well off with their expectations, and we are unlikely to receive any hawkish hint today by the generally dovish Bank of France Governor François Villeroy. Let's see if we hear some policy-related comments by Austria's Rober Holtzmann – normally a quite hawkish voice – as he participates in an event on regulation.

Either way, we doubt the EUR will be able to receive any positive push from a shift in the ECB rhetoric anytime soon, and we think that the rally in EUR/USD may find increasing resistance as it approaches the 1.1700 level.

GBP: Inflation pressure eases, but hawkish bets still on

UK inflation data released this morning showed both the headline and core rates inching lower (to 3.1% and 2.9%, respectively) in September. This may be a factor challenging the market's conviction around a BoE November 10bp rate hike, which is incidentally no longer fully priced in: the implied probability has slightly decreased to 80% over the past few days.

Our UK economist discusses why we think markets are overestimating the BoE's inflation challenge in this article, although considering the quite strong signals received from BoE members – and especially from Governor Andrew Bailey – any more de-pricing of rate hike expectations, does not look very likely in the very short term, or at least until we receive any hints from BoE members themselves. There are only two BoE speakers scheduled before the 04 November meeting: Catherine Mann on Sunday and Silviana Tenreyro on Monday.

For today, Cable may keep inching higher on the back of supportive risk sentiment, and looks set to test the 1.3850 200-day MA resistance soon.

CAD: Inflation may rise again, but BoC taper should go ahead regardless

The loonie has been supported at the start of this week amid a generalised upbeat risk tone and USD weakness, although it clearly lagged the bigger gains in other pro-cyclical currencies such as NZD, AUD and NOK. The global hawkish re-pricing has naturally included BoC expectations, and markets are now fully pricing in a 25bp hike in April 2022. Despite having received no hints in this direction from the BoC itself, recent data flow has surely been very encouraging in Canada (especially on the jobs market side) and the 3Q BoC survey showed record-high capex intentions.

Against this backdrop, we don't think the BoC needs to see another rise in September's inflation (released today) to go ahead with more tapering next week. Anyway, the consensus is looking for another acceleration in the headline rate from 4.1% to 4.3%, and any upside surprise may see markets bring forward the first expected rate hike to March 2022. If the risk environment does not deteriorate, we expect USD/CAD to face limited upside risk or to keep inching lower into next week's BoC meeting.

Authors

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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