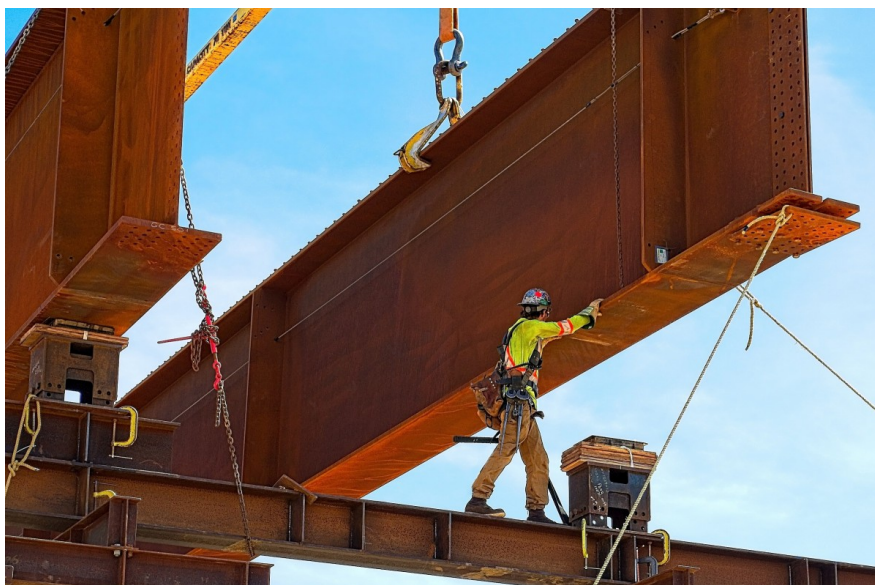


FX Daily: Many drivers, no clear direction

Markets are still re-assessing fundamentals after the ECB and the NFP last week, as bonds continue to underperform and the diplomatic stand-off with Russia remains a central theme, despite some reluctance to price back in risk premiums in foreign exchange. We expect the dollar to gently recover this week, with JPY set to remain a key underperformer



Canada's labour market has shown a unique ability to rebound from lockdown-induced slack

USD: Post-NFP market environment should favour US dollar recovery

The week in foreign exchange has started with some unconventional moves, as some lingering fragility in US tech stocks (following a decent European session for equities) and a modest pull-back in oil prices coincided with two high-beta commodity currencies – the Canadian dollar (CAD) and Australian dollar (AUD) – outperformance. AUD may be benefitting from some short-squeezing (it is [the most oversold currency in the G10](#)), while good fundamentals, despite last week's grim jobs figures, are likely generating some support for the loonie. We discuss this in detail in the CAD section below.

Back to the US dollar, some tighter trading ranges look warranted after a very eventful week that culminated with surprisingly strong NonFarm Payroll (NFP) numbers, and also given the lack of

market-moving data releases (nor Fed speakers). As markets await Thursday's consumer price index (CPI) figures, the US calendar includes the NFIB Small Business Sentiment index today, which is expected to have dropped in January, but the release should not have any major market impact. Geopolitical tensions in Ukraine/Russia remain a key theme to watch, as US President Joe Biden hinted at the possibility of halting Nord Stream 2 should Russia invade Ukraine. Still, markets appear more reluctant at the moment to price back in some geopolitical risk premium into the most sensitive currencies.

We think that Friday's payrolls numbers have helped build a floor under the dollar as markets should continue to cement their hawkish views on Fed tightening into the March meeting. Thanks to a more balanced positioning, we think the dollar could start rebuilding a moderately hawkish trend, with the low-yielding Japanese yen (JPY), which has come under a good deal of pressure on rising US yields, and the Swiss Franc (CHF) that could emerge as the biggest losers.

➔ EUR: Resilient despite less hawkish tone by ECB speakers

Euro / US dollar (EUR/USD) appears glued around the centre of the 1.13-1.15 range at the start of this week, showing some very moderate pull-back after the European Central Bank meeting and US payrolls last week. Interestingly, the euro (as well as ECB rate expectations) has not appeared too reactive to post-meeting ECB speakers' remarks. Yesterday, President Christine Lagarde took a chance to implicitly push back against the market's aggressive pricing on ECB tightening, stressing how the policy shift will be gradual and reiterating the notion of "sequencing" (i.e. no hikes before the end of asset purchases). Today, the normally dovish Pablo Hernández De Cos and François Villeroy de Galhau, respective governors of the Spanish and French central banks, are due to speak.

Our economics team outlined the [ECB's roadmap to normalisation here](#), stressing how many questions will need answers in Lagarde's new policy stance. A very central one is: how tolerant will the ECB be of widening sovereign spreads? Yesterday, the 10Y BTP-Bund spread briefly touched 165bp, having widened from 125bp at the start of February. An abrupt end to asset purchases surely risks exacerbating the widening of spreads that the ECB has been very careful at keeping in check in recent years.

In a longer-term perspective, this is one key point that argues against the current market pricing for a fast ECB tightening already in 2022, but before we get more clarity at the March meeting (and given the euro's limited sensitivity to ECB members' comments at the moment) we think EUR/USD should continue to consolidate around 1.13-1.15.

➔ GBP: Waiting for BoE speakers later this week

Except for the non-market-moving political turmoil in the UK, there are no other events or data releases to report on the GBP side today. Tomorrow and on Thursday, we'll hear from the Bank of England's Chief Economist Huw Pill and from Governor Andrew Bailey, and Friday will see the release of growth data. But for now, GBP may trade mostly range-bound.

While the ECB's boost to the EUR is translating into a supported EUR/GBP, we still think that a policy divergence in favour of the pound can bring the pair gradually back below 0.84 by the end of the quarter.

➔ CAD: Fundamentals underpin recovery

USD/CAD has wiped its Friday's gains, when a stark divergence between US and Canadian jobs figures for January drove the pair close to 1.2800. We think that markets are currently weighing the fundamental picture for the loonie, finding it still attractive, especially considering the recent CAD underperformance.

Indeed, Friday's figures were very grim, as employment dropped by 200k and the jobless rate spiked to 6.5%. However, Canada's labour market has shown a unique ability to rebound from lockdown-induced slack, and the latest Bank of Canada Business surveys indicating still record-high hiring intentions suggest there should be a solid base for recovery. Incidentally, wage growth dropped less than expected (from 2.7% to 2.4%), signalling lingering risks of persistent inflation.

We doubt that the Bank of Canada's tightening plans have been derailed by January's jobs data, and we forecast six 25bp increases by the end of 2022. This should offer support to the loonie down the road: for now, we expect USD/CAD to stabilise around 1.2600. Keep an eye on Bank of Canada Governor Tiff Macklem's remarks tomorrow.

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