FX Daily: Momentum is with the hawks

There has been no let-up in the upside pressure on commodity prices and inflation rates continue to accelerate around the world. The market is moving to price earlier and more aggressive tightening cycles, leaving bond markets under pressure and the currencies of central bank first-responders bid. Expect the dollar to stay bid as the Fed cycle is repriced

USD: Strong retail sales provides strong dollar undercurrent.

New Zealand has become the latest country to publish inflation figures way above anything expected. The 3Q21 figure of 4.9% YoY compared to a range of expectations from 3.8% to 4.5%. The number has sent 10 year NZ government bond yields some 15bp higher and is nudging the market back towards pricing a 50bp hike at the late November RBNZ meeting.

We mention the above New Zealand situation as an example of the market pricing earlier and more aggressive tightening cycles. Back in June, the market struggled to see the RBNZ policy rate being taken to 1.50% over the next three years. Now the policy rate is priced to 2.50% over the same horizon. And a similar story is playing out in the US. Back in June the market barely saw Fed Funds at 1.00% over a three-year horizon. It now sees it at 1.40%. But crucially that is still below the latest set of Fed Dots which sees the policy rate at 1.80% in 2024.

This hawkish re-pricing of the Fed cycle gained some momentum with the strong September US retail sales release. Far from limping into 4Q21, it looks like the US consumer has some momentum. The strong release prompted one of our preferred metrics of Fed tightening expectations - the 1m USD OIS priced three years' forward - to jump to a new high for the year. This is a dollar positive, especially against low-yielding currencies with dovish central banks and against energy importers. Expect USD/JPY to remain at the forefront of the dollar rally and we look for a test of 115.00 this week - potentially when a wider Japanese September trade deficit is published on Wednesday.

For today, look out for US September industrial production and a speech from Fed Quarles. Neither looks market moving but expect DXY to remain bid in a 94.00-94.50 range.

EUR: ECB remains on a different chapter

Most recent ECB stories relate to flexibility around their emergency support programmes. Clearly, the ECB want to be very careful about how it handles communication in December, when it will have to confirm that the emergency pandemic bond-buying PEPP scheme is coming to an end from March 2022.

Clearly, the ECB is on a very different chapter in the monetary normalisation story than, for example, the Bank of England. The low risk that the ECB switches to the hawkish camp keeps the EUR as one of the preferred funding currencies. 3m EUR implied yields are now -0.77% p.a., driven by the annual search for dollar liquidity to meet capital adequacy ratios. We favour EUR/USD pressing the lower end of its 1.1525-1.1625 trading range. In terms of this week's G10 calendar, Europe is quiet until the release of the flash PMIs towards the end of the week.

Elsewhere in Europe, tomorrow sees a rate meeting in Hungary. Our team expect a surprise 30bp hike from the NBH, which should help steer EUR/HUF back to the 355 area.

GBP: Another weekend passes without push-back from the BoE

Far from any push-back against the early pricing of the Bank of England tightening cycle, the weekend saw a fresh set of hawkish comments from BoE Governor Bailey. He is clearly in the camp looking to prevent high current inflation seeping into inflation expectations. For this week, the highlight will be Wednesday's release of September CPI. Consensus expects another 3.2% YoY reading, but the market surely must be bracing for a higher reading. And remember that the October figure will jump close to 4.0% YoY as the energy price cap is adjusted.

BoE hawkishness is seeing GBP better withstand dollar strength and driving some outright gains against the Euro. EUR/GBP has broken out of recent trading ranges and the continued pricing of early BoE tightening should drive EUR/GBP closer to 0.8400 - especially as the market continues to re-price the BoE terminal rate for the forthcoming tightening cycle.

CAD: Look out for the Business Outlook Survey

1630CET today sees the Bank of Canada release its 3Q Business Outlook. This survey of 100 firms on their sales, investment and pricing expectations/intentions is an important input for the BoC ahead of its October 27th policy meeting. This is a big meeting with a new Monetary Policy report released. Being on the right side of the commodity story and the US fiscal expansion should mean that the CAD continues to out-perform.

Strong readings from the outlook could bring forward expectations of the first BoC hike (now priced in around six months) and keeping CAD out-performing on the crosses. EUR/CAD looks on course to test a big low at 1.4250.

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