

FX Daily: Omicron-Powell tag team throws dollar around

Realised one-month EUR/USD volatility has spiked to the highest levels of the year as fears over Omicron, but hawkish comments from Fed Chair Powell throws the dollar around. Sharp flattening in the US yield curve warns that the dollar should stay bid against riskier currencies, yet investor rotation into under-performers offers some opportunities



US Fed Chairman, Jerome Powell, announcing a cut in US rates

➔ USD: Powell rocks markets

G7 FX volatility is on its highs for the year and it is not hard to see why. Over the last week news of the Omicron variant has inserted a new and, as yet, unsized risk premium into global asset markets. Yet yesterday, investors read a clean set of hawkish headlines from Fed Chair Powell, including remarks that it was time to retire inflation's description as transitory and that it may be appropriate to conclude tapering a few months earlier. The US yield curve took its cue from this combination of events, with the 2-10 year Treasury curve flattening a huge 14bp on the view that the Powell Fed would push ahead with tightening, irrespective of what Omicron meant for growth.

Normally a flatter US yield curve is a deflationary signal, i.e. the monetary brakes are being applied and that is bad news for pro-growth, risk-sensitive currencies and normally good for the dollar. However, with the dollar already close to the highs of the year on the Fed normalisation story, the

current environment certainly looks more mixed. Commodity currencies, such as the Canadian Dollar and the Russian Rouble (two of our favourites) have found some good support after a recent battering and the dollar has struggled to hold gains against the low-yielders such as the EUR.

In fact, there are indications that investors are using these uncertain times to rotate from out-performing western equity markets and back into the perceived better-priced markets such as Korea, where both local equities and the Korean Won enjoyed strong overnight gains.

Where does this leave us? US data should continue to show strong numbers over the coming weeks (ISM and ADP today) which will foster expectations that the Fed could turn more hawkish at the December 16th FOMC meeting (in spite of Omicron). That should mean that the dollar dips against the high yielders, prove shallow. This new Fed hawkishness muddies our view that the dollar could correct lower into year-end on the slow-down in balance sheet adjustment activity.

Levels like 95.50 in DXY and 1.1380 in EUR/USD are key chart points, determining the extent of the current dollar correction. Powell's intervention yesterday is a factor that argues that these chart points stay intact.

➔ EUR: Wild ride

As above, realised EUR/USD volatility levels have jumped as spot has been buffeted by Omicron (EUR/USD +ve on implications for Fed policy and unwind of EUR-funded investments) versus Powell's remarks (EUR/USD -ve on the view that inflation is now the Fed's primary concern). Both themes will be fed many fresh inputs over the next four weeks and thinning liquidity conditions point to bumpy conditions in FX markets.

Yesterday EUR/USD stalled at a key chart point at 1.1380 right before Powell's comments hit the newswires. Powell testifies again today - this time to the House at 16CET. Powell's remarks did sound like a deliberate policy shift yesterday and it would therefore seem unlikely that he rows back on them at today's hearing. Similar remarks can help cement 1.1380 as the top of the range - meaning 1.1180-1.1380 could be the range for coming weeks. A break above 1.1380 would be a surprise and open up 1.1440 then 1.1500.

In Europe, the focus today is on the final release of November manufacturing PMI indices. These have actually held up quite well despite renewed lockdowns. Let's see if there are any downward revisions in the final release.

Elsewhere, we continue to see high inflation numbers across the region, including a [7.7% YoY print in Poland](#). CE4 currencies have found some support this week (see HUF below) and supportive comments today from NBP Governor Glapinski, plus FT reports of improving relations with Brussels suggest EUR/PLN could continue to drift lower.

⬆ GBP: Bailey emboldened?

It may not be the right forum to discuss monetary policy, the 15CET topic of a speech today is Insurance Regulation, but BoE Governor Bailey may feel emboldened by yesterday's comments by Jay Powell. In short, inflation is a problem to be treated seriously and in fact, maybe policymakers' top priority right now. Having moved to price out a December 16th BoE rate hike, investors may start to put a 15bp hike back into UK money market rates.

EUR/GBP may have corrected enough (0.8540) for the time being and unless equities have another

large leg lower (which would hit the high beta GBP) the theme of high inflation and policy normalisation, should provide some support for the GBP.

HUF: NBH gives itself room for tighter policy

The National Bank of Hungary (NBH) yesterday adjusted its policy rate corridor to 4.10-1.60% from 3.05%-1.15%. The move allows the NBH more flexibility with its one-week deposit rate, which tomorrow is expected to be raised to 3.05% from 2.90%. In theory, the NBH could then raise its one-week deposit rate to 4.10% should the Forint stay under pressure. CE4 currencies have found more stability this week on the back of a firmer EUR/USD. The NBH's new measures will build the view that the NBH really does not want a weaker Forint and that the 370 level in EUR/HUF will be some kind of line in the sand for the NBH

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