

FX Daily: Policy diversion remains the big driver

The Bank of Japan has changed their assessment of inflation risk to "balanced" but only minor revisions to the CPI forecasts mean no change in policy is on the horizon, adding to pressure on the Yen. Good UK jobs data is supporting hawkish BoE bets and the pound, while a light calendar can allow dollar longs to re-emerge thanks to the prospect of Fed tightening.



Source: Shutterstock

USD: Room to re-build long positions

US markets re-open today after yesterday's holiday closure, and stock futures point at a negative open in US and European equities after a mixed Asian session.

The dollar stabilised after Friday's recovery against most G10 currencies, although the commodity FX segment was supported with, once again, the oil-sensitive NOK and CAD outperforming the rest as crude prices kept inching higher.

Today, data will be back in focus in the US, with the Empire Manufacturing index for January set to

fall due to Omicron impact. Later in the day, we'll see some housing figures as well as November TIC flow numbers. All in all, the data releases should have a quite contained impact on the FX market today, and the pricing of Fed tightening heading into next week's FOMC meeting should remain largely unchanged, also given the lack of Fed speakers in the pre-meeting blackout period.

We have seen a tendency of the market to sell the dollar around key data releases (NFP, CPI), so the lack of major data inputs in the run-in to the Fed meeting should offer some room to rebuild USD longs that were unwound in the first two weeks of January. Another grim day for global equities may also help the dollar to find some support.

↓ EUR: ZEW in focus

The ZEW survey out of Germany this morning will be a chance to monitor whether the Omicron-impacted outlook for the eurozone has stabilised in January. Even more importantly, it will provide a key gauge of inflation expectations, which peaked in June before decreasing in the latter part of 2021.

However, a new jump in inflation expectations might offer some support to the EUR, although that should prove quite contained given the reasonable reluctance to price in a hawkish shift by the ECB in its upcoming meetings. ECB-Fed policy divergence continues to point to a weaker EUR/USD, and we expect the pair to retreat below 1.1400 by the end of the week.

➔ GBP: Data doing little to challenge hawkish BoE bets

In a trading day starting with general USD strength across the board, the pound is holding up well, helped by some good jobs data released this morning. After showing resilience to the end of the furlough scheme, the UK labour market continued to tighten in November, with the unemployment rate moving a notch lower, to 4.1%. Wage growth decelerated, but not more than consensus and remained above 4.2%.

We think that the Bank of England's rate expectations (four hikes by the end of 2022) are overdone, but this morning's jobs data as well as tomorrow's CPI data – in our view – are set to do little to challenge the current hawkish bets. Ultimately, this means that the pound's good momentum, which has remained immune to the UK's political noise – should remain broadly intact into the 3 February BoE meeting. EUR/GBP remains on track for a move below 0.8300.

➔ JPY: BoJ disappoints hawkish expectations

Mounting hawkish expectations around this morning's Bank of Japan meeting were largely disappointed as the first change to risk assessment to inflation since 2014 – from "tilted downwards" to "balanced" – was accompanied by an only marginal revision of CPI forecasts. The Bank's inflation estimates are now 1.1% for both FY2022 and FY2023, compared to the previous 0.9% and 1.0%, respectively, figures that hardly suggest an imminent change in the BoJ's ultra-dovish stance. Incidentally, Governor Haruiko Kuroda poured cold water on any speculation that a potential rate hike in 2024 was being discussed.

The yen came under pressure in the Asian session, with USD/JPY extending yesterday's gains to push the 115.00 level. We think there is further room for the pair to rise on the back of rising US treasury yields in the near term, and we expect a convergence to the early-January 116 levels. For today, however, new signs of fragility in the equities as US markets re-open after a long weekend

may help the yen find some stabilisation.

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